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AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

of the National Association of Real Estate Boards

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CONTENTS

Vol. 1

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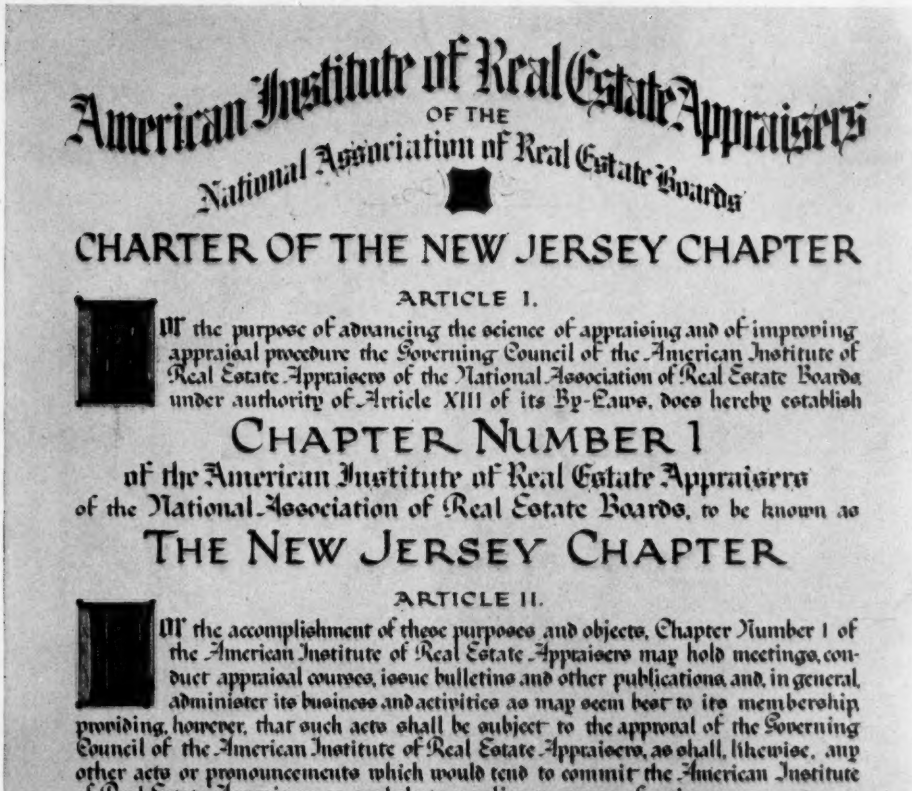

American Institute of Real Estate Appraisers
OF THE
National Association of Real Estate Boards

CHARTER OF THE NEW JERSEY CHAPTER

ARTICLE I.

For the purpose of advancing the science of appraising and of improving appraisal procedure the Governing Council of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards under authority of Article XIII of its By-Laws, does hereby establish

CHAPTER NUMBER 1

of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards, to be known as

THE NEW JERSEY CHAPTER

ARTICLE II.

For the accomplishment of these purposes and objects, Chapter Number 1 of the American Institute of Real Estate Appraisers may hold meetings, conduct appraisal courses, issue bulletins and other publications and, in general, administer its business and activities as may seem best to its membership providing, however, that such acts shall be subject to the approval of the Governing Council of the American Institute of Real Estate Appraisers, as shall, likewise, any other acts or pronouncements which would tend to commit the American Institute of Real Estate Appraisers as a whole to a policy or course of action.

ARTICLE III.

Membership in any grade in the Chapter shall be open only to individuals who are members in good standing in the corresponding grade of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards.

ARTICLE IV.

The territorial jurisdiction of the Chapter shall be the political boundaries of the State of New Jersey.

In Witness Whereof, the American Institute of Real Estate Appraisers has caused these presents to be signed in its behalf by the President, Secretary and Governing Council, and its Corporate Seal to be hereto affixed on this seventeenth day of November, A. D. 1932.

President

H. W. Nelson
Secretary

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Above is a facsimile of the Charter granted to the New Jersey Chapter on November 17, 1932. Charters have been granted also to chapters in Florida, Ohio, California, and the Metropolitan area of New York City.—Ed.

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A New Approach To Urban Land Valuations

By WALTER R. KUEHNLE, M. A. I.

FOR some years it has been a growing conviction of mine that the valuation ascribed to the urban lands in the United States is too high. I believe, also, that whatever affects real estate, affects realty values and markets, and whatever alters values and markets alters underlying security and affects the entire structure of the Country.

We all recognize that this is a critical period in the history of our Country; and there is no doubt but that there is a very definite demand on the part of the people for a complete change of ideas in certain of our business and governmental affairs.

One of the most fixed of all quantities is land; there will never be any more of it—there will never be any less of it. Everyone in the world must use land, if they would live, but in spite of the fact that under all is the land, the history of the world is dotted with examples of speculation, showing a complete lack of understanding of its utilization and value. Speculative crazes are not new—they began in the modern world with the tulip mania in Holland in 1636, when tulip bulbs were sold up to $1,400 per pound. In 1719 in France, the Mississippi scheme of John Law skyrocketed shares from 500 to 8,000 livres within a short time. In 1720, the south sea bubble of England broke all previous records when stock of the South Sea Company rose from 180 to 1,050 pounds and dropped back to 200 pounds, all within six months. In addition to the speculation in the shares of the South Sea Company, there was an insane promotion of companies with such fantastic objects as the extraction of gold from seaweed and the importation of jackasses from Spain, and finally, shares were sold in a company for an undertaking, "the purpose of which shall in due time be revealed."

Land Speculation

In the United States, however, speculation has been more generally connected with real estate, whose physical solidity belies its use as a financial bubble. The lure of land profits has ever tempted the American people, and from the very discovery of our Country, history is replete with incidents of speculation in lands. It is alleged that Christopher Columbus embarked upon his voyage of discovery on a commission basis with a perpetual guarantee of ten per cent of the rents and profits of the new world.

North America was colonized by land companies, and the struggle for huge land grants was a feature of colonial history. An important but generally neglected cause of the Revolution was the action of England in forbidding the colonies to acquire land west of the Alleghenies. The speculative feature characterized town lot promotion in the United States from the beginning of its history as an independent nation. In this very city of Washington a boom was engineered in 1796, and the three speculators who promoted it constructed a number of houses in an effort to attract settlers. These houses were never occupied and fell into ruin, and the three speculators who formerly were men of great wealth and position, were unable to leave their houses because of the droves of creditors who sat on their

Mr. Kuehnle delivered this address before the Institute in Washington, D. C., on Wednesday, January 25, 1933.—Ed.

doorsteps with writs of attachment. They were finally forcibly lodged in a debtors' prison; and all this was despite the fact that they paid only from $40 to $80 each for the lots they bought, and that the city of Washington has today surpassed the claims made for its future greatness in the literature of that time. Some insight into the toll taken by the compound interest in land speculation may be given by the fact that one of these $80 lots would have to sell today for a quarter of a million dollars, to return the capital of $80 invested and compound interest at 6% per annum accruing since that time. This is without regard for taxes or special assessments.

The subdividers of New York City in 1836 laid out enough lots to provide for two million people, and enough lots were laid out in the alligator infested swamps of New Orleans to house a million persons. In the same year, when Chicago was a town of 4,000 persons, and just four years after the scare of Indian invasion during the Blackhawk War, 500 towns that are now cornfields were platted in Illinois, and town sites were surveyed at the mouth of every brook that ran into Lake Michigan.

The speculation in town lots was revived again when a new generation came on the scene. In 1856 came the boom in Kansas town sites. From 1868 to 1873 was a period of post-war speculation, similar to that which ended in 1929. In this new era, speculative land booms were engineered in New York, Chicago, San Francisco, and hundreds of other cities. In 1887 and 1888, in the vicinity of Los Angeles, which had an aggregate population of 3,500 there were laid out 60 towns and cities, covering 80,000 acres. Lots skyrocketed from $500 to $5,000 in a year and dropped back the following year. Kansas City, Omaha, Minneapolis, and Duluth were being boomed at the same time. In the 1890's there was wild speculation in the vicinity of the World's Fair Grounds in Chicago, and there are at this time 20 ft. lots on the sand dunes of Indiana that were subdivided and sold at that time. The Alaskan gold rush of 1897 started a rush for lots in Seattle and Tacoma, which finally culminated in the great boom of 1905 and 1906. St. Louis had its World Fair boom in 1904. Prior to 1914, there was wild lot speculation in the cities of the Canadian northwest. 1925 witnessed the Florida boom. In a Florida city in which I made an appraisal of the central business district last year, enough lots were subdivided to provide for 400,000 people, although the population of this city is only 40,000.

Land Values Today

The speculative phase of real estate has not, however, been limited to subdivisions that spread out far beyond the limits of various American cities. I am suggesting at this point that the valuation ascribed to all urban lands in the United States is too high,—even those held in theory to be the most stable because of their location in the Central Business Districts. I am further suggesting that a large portion of the values ascribed to urban land in the United States is a state of mind and that any system of credit and taxation based upon a foundation of such values must ultimately collapse. Some of the water has been squeezed out of urban land during the trying times of the last few years and the sooner we squeeze out the rest of the water and get on a sound economic basis for credit and taxation the sooner we shall enjoy economic recovery and the benefits of the return of normal business. The alternative is continued stagnation for a long period of time.

Most of this mental value assigned to our urban lands is the result of the theory of the scarcity of land and that all land if held long enough must pay

out as an investment. Many factors have operated in the past decade to dissipate these theories.

The first of these factors is improved transportation. In the horse and buggy days people were forced to live within six miles of their place of business because of the time required to come and go in a horse and buggy or a horse car. This gave a scarcity value to land close in to the centers.

Log roads, horse-cars, cable-cars, elevated lines, electric surface cars, electrified railroads, and good hard roads all followed in rapid succession.

An example of how modern transportation may lessen the intensity of the use of central areas is given by the Borough of Manhattan in New York City. Although the city of New York increased in population from 1920 to 1930 from 5.6m to 6.9m the Borough of Manhattan declined from 2.3m to 1.8m.

In 1836, the population of the City of Chicago was located largely along the Chicago River because land vehicles could not operate in the vicinity due to the lack of good roads and deep mud.

Observers of the time tell of the crowded condition in the hotels and that even the stores were used for sleeping accommodations. With the building of the log roads, this condition was alleviated by the city spreading out from the River. Thus the building of these roads had made land less scarce. Each improvement in transportation that made the business centers accessible to more remote localities, extended the area of all our great cities until now it is said that the supply of urban land is virtually unlimited.

There are additional complications brought into the problem by vertical expansion as well as horizontal. Large cities have shown a tendency to build higher and higher buildings thus requiring less land.

An analysis of the urban land in the United States will reveal that a very small percentage is improved with modern up-to-date buildings to the full extent of its possibilities. The balance, be it vacant or improved to a very moderate degree with old obsolete buildings, is based upon the anticipation of a higher and better use than that now employed despite the fact that all such land cannot possibly come into such use at any reasonable future date. Business land in the center of our cities has a value based upon the assumption that it will ALL be developed with skyscrapers with the maximum height permitted by the city zoning ordinances. Land on the gold coast is valued on the basis of being completely built up with twenty story deluxe apartment buildings. Land on the outlying business streets is ascribed a value on the theory of continued expansion of retail stores paying high rents. In the light of the unlimited supply of lands for these purposes, what basis of fact have we to make such assumptions and to use them as a foundation for our important financial and tax structure? It is stated that if all the land in Chicago were built up to the limit allowed at present by the City zoning ordinances, the entire population of the United States would be accommodated within its city limits. At the present time in this city there are approximately five million front feet zoned for business and only one and one-half million front feet occupied by business uses. The unused portion would be adequate to supply an estimated additional seven million persons. Niles Center, a suburb of Chicago, with a population of 5,200 has enough business frontage for a city of 580,000.

Concentration

Existing business property has felt the growth of the chain store which brought about the concentration of the business area into a smaller compass. Thus instead of a possibility of further

expansion in the store area so that new store buildings will be required, there has been a contraction so that there are now rows of empty stores without tenants. A combination of over-expansion during the days of easy financing and existing business conditions has caused a large percentage of vacancies in all types of existing buildings from office buildings to apartments and factories.

Population increase alone can cause all these lands not improved to their highest use, to come into the high use upon which they have been valued. According to the "Committee on Social Trends" we will soon be faced with a stationary population. Heretofore, our rapidly expanding population has caused increased demands for lands. If the conclusion of the committee is correct it would seem that the human material necessary to bring much more of this land into use is no longer available. After the Illinois town site boom of 1836 collapsed, a reporter facetiously remarked in a news story that he had perfected a gigantic chemical plant out of whose vast cauldrons enough people could be manufactured overnight to fill any townsite. Perhaps the invention of such a machine would justify the value we have ascribed to our urban land.

Amount of Vacant Urban Land

With only a very small percentage of the total available urban land now improved to its highest use with modern buildings suited to the location it is absurd to predict that the great entire balance will also be brought into such maximum use at any reasonable future date. If all of the land, either vacant or improved in the city limits of all cities in the United States of over thirty thousand population were put in one compact area, it would comprise a body of land of three million, eight hundred and forty-four thousand, six hundred and twenty-two acres. This amount of land, though it contains a population of over forty-five million people, is not a large area compared with the total land area of the United States, in fact, it would not cover half of the state of Maryland. It would represent only one-fifth of one per cent of all of the land in the United States. The area of American farm land would be two hundred and forty times as great. Yet, in 1922 this body of urban land was ascribed a value of at least as much as all the farm land in the United States, and the valuations which aggregated this staggering sum were alleged to be conservative.

In 1928, the situation was far worse, for while the value of farm land had declined from fifty-five to thirty-five billion dollars, this urban land in cities over thirty thousand had been inflated to in the neighborhood of seventy billion dollars. In other words, one-fifth of one per cent of the land in the United States was ascribed a value of double the value ascribed to ninety-nine and eight-tenths per cent. Only a very small portion of urban land in the United States is earning on this mental value ascribed to it, so there is no justification of such value.

Effect on Credit and Taxes

The vacant urban land in the United States was said to comprise one-fifth of the entire national wealth in 1928. This means that taxes and credit lean heavily on land values. If these values are economically unsound and do not earn their way, the tax and credit structure for which they form the foundation must inevitably collapse. And it has. Banks have closed their doors. Mortgages have defaulted. Tax delinquencies have mounted. Last year in Chicago they mounted to forty-five per cent. And those cities who have as yet not reached this stage had better not congratulate themselves too soon. They may be on the way. It seems our main difficulty in connection with this problem of land value is that we have

failed to adjust our ideas from the horse and buggy days to the greatly changed conditions of today. As a result of the belief that urban land is constantly increasing in value it has been necessary to construct higher and higher hypothetical uses for the land. On the basis of these higher hypothetical uses, greater credits have been extended *on* the land and higher valuations for taxation have been ascribed *to* the land. The fact has been ignored that the higher uses, have been adding to the over-supply, at a much greater rate than our ability to absorb.

The Need for Data

Accurate community statistics would dispel many of these illusions which have caused us so much difficulty. Defaulting mortgages and delinquent taxes have brought this problem, with its attendant need for more accurate information not now available, forcibly to the attention of banks, insurance companies, and governmental bodies, as well as to the property owner and investor. Present sources of information on the subject are so sparsely developed that the insurance company which loans millions of dollars a year upon real estate mortgages is relatively little better off in its attempts to forecast the future of its investments than is the citizen seeking a safe investment for a few thousand dollars.

The need for an Institute to supply accurate, up-to-the-minute information on community statistics is clear. It is essential for correct measurement of current needs for new construction, for the consummation of real estate deals on a sound basis, for the placement of mortgages, and for the levying of taxes.

No individual appraiser nor single instituton, whatever its resources, could afford to gather for its own use alone, the vast fund of information which would be necessary to the complete success of such an institute. It should, therefore, be formed as a consolidated undertaking of all groups interested in accurate information on facts affecting the value of real estate.

Among the many things that could properly be given consideration by such an organization are:

(a) Existing and past supply of space in industrial and commercial buildings, and of units in residential buildings.

(b) Existing demand for such space as is indicated by occupancy surveys of land and buildings, and the prevailing rentals.

(c) Immeasurable factors influencing future demand and values such as population, growth, movement, and composition.

(d) Items affecting demand and values but which cannot be measured so readily, such as change in style.

(e) The measure of demand for vacant land and buildings, for the various types of occupancies that will produce the income which is the basis of the value of all real estate, vacant or improved.

Consideration might also be given to figures on existing mortgage holdings, new writings, cancellations, losses, receiverships, etc. These data could be classified with reference to mortgages, mortgagor's type of property, locations, liens, foreclosures, and the cost of receiverships—this latter, in many of our major cities, has already assumed the proportions of a national scandal. In that connection the advisability of collecting local financial data to get an idea of national trends, might be helpful. The causes for this great expansion in the values ascribed to land can only be made understandable through intelligent research undertaken by trained analysts and appraisers. Only through such research and the establishment of an organization to keep current data relating to community statistics will we dissipate existing false theories of value and keep on a basis of sound values of real estate both vacant and improved, for purposes of both credit and taxation.

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The Modern Percentage Lease

By CAPT. HENRY WOLFSON

THE scientific approach to the solution of any problem is to find the cause and effect and then suggest a remedy. We shall therefore subject the immediate past to a careful analysis and find out what conditions existed and the results that followed. It is only after we fully understand the situation that we can intelligently discuss any possible solution.

The halcyon days of the late twenties witnessed a great expansion in all lines of industry. Business real estate was no exception. Under the leadership of the chains, retail stores everywhere expanded their activities. This rapid expansion brought into play many destructive forces and unhealthy practices. The "major domo" of the evil forces of this period was the lease speculator. He capitalized his only possession — wits. He picked out some of the choicest locations in our leading cities, closed long term leases, and sat back to "cash in". He was mobility personified, and since he gambled with other people's property, he did not have to dally in closing his deals. He was motivated by one thought — extract "all that the traffic will bear", and he literally extracted everything. It should be pointed out that there is a marked distinction between an operator and a speculator. The former improves the acquired property and is entitled to a profit from the venture; the latter adds no improvement to the property itself and merely reaps the harvest of the inexorable law of supply and demand. Legally permissible, but morally indefensible! I submit it is unsound public policy to place tenants at the mercy of an unconscionable speculator.

Next we find the pernicious competition for locations which rests squarely on the shoulders of a majority of the chain stores. The mad scramble for new stores was initiated by them. Every choice location was virtually sold on the auction block. I know of a location where the owner quoted a rental of fifty thousand dollars a year, but before the tempest of competition subsided one of the contestants was the possessor of the leasehold at seventy-five thousand a year. Alas, he has it no longer — it is back with the landlord. I recall another instance of a property offered to us by the landlord at fourteen thousand a year and before the day was over he had closed a lease with another chain store at twenty thousand.

Competition

Then again, during this hectic period some of the chains aided and abetted by brokers, blessed with more enthusiasm than knowledge, came to the erroneous conclusion that the millenium had arrived. They figured all that had to be done was to obtain a 100% location — never mind the rent — begin operations — and success was bound to result. Competition was totally ignored. Somehow the fact that there is a saturation point was not considered. They failed to see that any given city can successfully support only a limited number of similar type stores. The result of over competition was disastrous in two ways. The sales volume of competitors was materially cut — and their own estimated volume failed to reach expectations. When it is considered that in addition the new comer had the added burden of a high-

Capt. Wolfson delivered this address before the Institute in Washington, D. C., on Friday, January 27, 1933.—Ed.

er rent than his already established competitor, a fair idea of the havoc can be calculated.

Chains in the Real Estate Business

Another angle is that the majority of the chains whose primary function was always that of merchandizers entered the real estate field. I am not unmindful that some chains—you know them as well as I do—had always subordinated their merchandising operations to Real Estate speculation—but they are not our concern. They went into it voluntarily—whereas most chain stores were forced into it through the exigencies of circumstances. I hold no brief for anyone, I am not defending anybody, but I know whereof I speak when I tell you that it was not by choice that chains entered the real estate business, but by absolute necessity. Whether the policy of expansion was good or bad, that is not germane here, but since the chains wanted to expand, there was no other way they could do it—they just had to dance the tune played by the piper.

It is evident that a landlord who was flooded with *bonafide* offers on a "net" basis for his entire property could not reasonably be expected to entertain an offer that involved only part of the property on a "gross" basis. We are not living in Utopia. The result, of course, was that with the acquisition of surplus space the vicious circle of sub-dividing and sub-letting began. Individual tenants seeking locations, or chains requiring small units, bowing to the supposed "superior" judgment of the chain specialists, entered into leases at fantastic figures which ultimately, due to declining volume, either had to be drastically reduced or tenants were forced out of business.

High Pressure Selling

The next development was the high pressure sales to investors and institutions of property leased to chain stores on a net basis. This should be of special interest to you as appraisers. These properties were sold not on their conservative value, but on the "capitalized" basis of the rentals paid. *No other factor was considered.* The only question asked was "what does the chain pay?" The sale was usually made on a six to nine percent basis, depending on the financial stability, earning record, and credit rating of the organization back of the lease. For example, a property leased to a prime chain renting for $12,000 a year net, was sold for $200,000. Primarily, sloughed off on a "boom" basis, these investments are only as good as the tenant. When the chain that took the lease went broke the poor investor had a very poor investment. Unquestionably, many of these investments remain exceptionally good even today, but the principles involved in the set-up are no less subject to question. This type of transaction had its repercussion in the re-financing after the sale either by way of mortgages or bond issues. For these mortgages, too, were placed on the basis of the inflated "rental" without any thought to the sound basis of real "value". I am not unmindful that "income is of prime importance" in appraising investment properties but I submit that boom time income is not a fair yardstick to use.

Net Leases and the Tax Load

Finally, in addition to any other type of "anti-chain" legislation, and as you know we are plagued with enough of them, the chain stores were penalized by municipal authorities for making net leases. No sooner was a lease placed on record obligating the chain to pay the local taxes than the assessment went sky-high. "Let the chains pay—they are 'furriners' anyway", became the slogan of the day. There was deliberate discrimination against the chains—not everywhere, to be sure, but in sufficient proportions

to become alarming. We, ourselves, had a glaring instance of it in one city. The taxes on the property prior to our leasing it amounted to $600. After we took possession we improved it and estimated that our taxes would be eighteen hundred dollars, but actually the new assessment called for a tax of $8,000. Through the intervention of our landlord the tax was reduced.

These are the cold brutal facts—they speak for themselves. The picture has been painted in broad strokes, the details have been eliminated. You have seen that Landlords, Tenants, and Brokers had some place in it. No one group monopolized it to the exclusion of the others. If the picture is not a pleasant one to contemplate,—and it is not,—we can at least get comfort from the fact that it records the events of the *past*—and let us fervently resolve that when the history of our present period is recorded that it will reflect the brighter and happier "New Deal".

The "New Deal" in leasing retail property contemplates a lease that is fair to the landlord and tenant. Is there such an animal? There is. I am not suggesting any panaceas, cure-alls or magic formulae. Just a sensible solution. Its success, however, is predicated on understanding and cooperation. First, landlords must discard their former conception of rentals and face present conditions. Revision and revaluation are the order of the day. They cannot expect a tenant to pay out two dollars if he only takes in one. It cannot be done. Second, mortgagees must adopt a liberal attitude toward the landlord who is struggling to hold on to his property. Wherever necessary, interest rates must be reduced and amortization charges certainly must be deferred. Third, taxes must come down. The cynics will say this is an idle dream; but, mark you, co-operation can accomplish the former, and an alert, aroused, determined, and vigilant electorate can achieve the latter. Truly, today taxes stand Cerebrus-like in the pathway of recovery. Finally, since this is a tenant's market exclusively, the tenant must be eminently fair in his dealings with the landlord. It is a question of "live and let live". In the words of Saint Paul, "None of us liveth unto himself".

Types of Percentage Leases

With this background we can now discuss the "Percentage Lease". Simply, it is a lease whereby the tenant is obligated to pay as rental a certain percentage of the total sales made upon the leased premises. Instead of binding himself to pay a DEFINITE rental regardless of the volume transacted, the tenant pays a rental which is based solely on his sales. For example, you lease a store on a 6% basis. If the store does a volume of $100,000 during the year, the landlord would receive from you as rent for that year $6,000. Whether the sales go up or down, your rent is fixed—you pay no more and no less than 6% of the sales. This is the simplest form of the percentage lease. Some percentage leases carry "minimum" guaranteed rentals; that is, the landlord is assured a stipulated "fixed" rent, usually paid in monthly installments, even though the sales made by the tenant may be less than the amount covered by the "minimum guarantee"; some carry "maximum" rentals so that the landlord only shares up to a certain volume; while still others call for a percentage of the "profits" of the enterprise.

Percentage leases are neither new nor novel. Leases on farm property have for centuries recognized the principle of "sharing" the produce of the land between the landlord and his farmer-tenant. The chain stores may have modernized it, but they did not conceive it. In the past, percentage leases have also been sought in periods of depression—but were taboo in prosperous times. How often have

I heard "Why should we be penalized for the amount of business we attract because of our ability? Why should we share with the landlord our hard-earned profits for building up his property?" No answer need be made to these questions. They reflect the attitude of mind that takes all — and gives nothing. "When business is good I will reap the harvest — when business is bad let my landlord reduce the rent". The percentage lease does away precisely with this injustice. The burden is equalized. It is the fairest kind of a contract.

Minimum Rentals

Let me point out that percentage leases made in the boom days did not work out because the tenant usually paid as a "minimum" rental the amount he would ordinarily have paid on a "straight" basis. The only benefit to the tenant was that "graduated" rentals were eliminated. In other words, the landlord was paid market value and gambled on the percentage feature for any increment; the tenant still paid a high rent to start, but was saved from paying any fixed increases. Fifty-fifty: the landlord gave nothing — the tenant got nothing. You can well see that the principle was wrong. In normal times a fair percentage lease should carry a minimum guarantee of 20% to 30% less than the market value, depending on the property and the type of tenant.

Percentage leases are not limited solely to retail merchants. There is a percentage lease in Chicago covering the land at the Southwest corner of Michigan Avenue and Madison Street. The size of the lot is eighty feet on Michigan Avenue by a depth of one hundred and nine feet on Madison Street. It is a ninety-eight year lease from May 1, 1928 and in addition to the rentals reserved in the lease the lessee was obligated to erect a building not less than twenty stories to cost at least $1,500,000. Actually a thirty-nine story building was erected and is known as the Willoughby Tower. The "Fixed" rental is five years at $125,000 per year, five years at $150,000 per year, five years at $160,000 per year and the balance of eighty-three years at $175,000. All these figures are NET. In addition the landlord "shares" to the extent of fifty percent of any excess over $75,000 per year (above all carrying charges) for any of the first five years of the term, or in excess of $100,000 for any of the remaining ninety-three years of the term. I do not approve this type of percentage lease. It is entirely one-sided.

Another percentage lease of major importance is the Sears Roebuck lease on the Leiter property in Chicago. The property has a frontage of 400 feet on State Street, between Van Buren and Congress Streets, and a depth of 143 feet. The improvements consists of an eight-story and basement department store building. The lease is dated September 28, 1931 for possession March 1, 1932, and the term is 20 years. The rental is 1½% of the gross sales without any minimum guarantee. Both the lessor and lessee have the right to cancel under certain conditions.

Flexibility

Other percentage leases have been made by gasoline service stations, paying one to two cents on a gallon of gasoline and two cents on a quart of oil. A recent theatre lease provided a minimum rental of $18,000 plus one-third of the net profits up to $30,000. A lease was recently made for the basement of Loew's State Theatre Building for occupancy as a restaurant on a 5% basis, but with a provision that the percentage is to be tripled in case of repeal of the prohibition amendment. A New York Bank made a percentage lease whereby it is obligated to pay 1% on the average net deposits up to one million and ¼ of 1% on deposits in excess of that amount. The mini-

mum guarantee is $8,000 and there is a provision for a maxmium of $15,000. The percentage lease is flexible and adaptable to changing conditions.

The lease closed in October, 1932 by Stern Brothers Department Store in New York, is probably the most gigantic percentage lease ever made. It affects one of the choicest locations and finest department store buildings in America. It comprises 234 feet on West 42nd Street, 100 feet 5 inches on Sixth Avenue, and 442 feet on 43rd Street. It involves a "minimum" guaranteed rental of about $700,000 and carries a 4⅛% sales percentage clause. Strictly from the record, because I have no inside information, I can definitely assert that there could not have been a deal except on a percentage basis. The Gerry portion of the property was leased in 1932 on the very same rental basis that it was leased in 1912. Even with the deplorable conditions that exist today, we know that rental values on this block have not gone down to the 1912 level. The percentage lease solved the problem.

Depression Rentals

Percentage leases made at depression rentals have proven very successful. Landlords have received far in excess of their "minimum" guarantees. This is natural. We have all been hit so hard, that we are much more prone to under-estimate anticipated volume than to over-estimate it. I can give you many examples, but one will suffice for illustration. One of the grocery chains took a lease on a certain store and during the negotiations advised the broker that it estimated its sales in that location at about $500,000. After one year of operation, I am informed, the store did in excess of $950,000. The owner actually received nearly three times the minimum guarantee.

Under present conditions a landlord should give preference to percentage leases as against "straight" leases. The potential advantage to the landlord is tremendous. Commodity prices have touched bottom. The dollar today buys about 40% more than it did in 1928. When prices again reach normal levels, though the tenant may not actually sell to any more customers than he is today, the sales automatically increase. Then again, experience teaches us that with the purchasing power of the public restored, volume, too, will increase.

What Rate of Percentage?

The question of the rate of percenttage that a tenant should pay is of the utmost importance to the landlord. No definite rate for any line of business can be fixed because many factors enter. Local conditions, operating expenses, mark-up, minimum wage laws, local taxes, the location and size of property, investment in furniture and fixtures, competition and sales volume, all have a direct bearing on the percentage of rent that can and should be paid. Surely you would expect a high grade retail shop with an exclusive clientele to pay a higher rate than a mass volume store. Chain grocers with large volume and small margin of profit must pay a smaller percentage than a jewelry store with small turnover and large profits. Then again, a store doing a half million can pay a larger percentage than a similar type store doing one hundred thousand.

It has been pointed out that a tenant may defeat the possible increase in volume, which would give the landlord a higher rent, by actually selling *less* merchandise at a *higher* mark-up. Also that a landlord may be penalized in the event that the unit is poorly managed and the tenant lacks proper financial resources. These two objections are valid but can be answered in three words "Choose the tenant". Unless the right tenant is secured—the percentage lease will be burdensome. Great care must be used in this re-

gard. Let a landlord beware of high-pressure salesmanship — let him not be stampeded by the glib-tongued tenant who promises him the millenium. Caution and prudence should be the watchword!

The Rule of Reason

Sometime ago I saw in a set of rules promulgated by a Western building managers' association that no straight percentage leases should be made for a period longer than six months without a recapture clause. I do not favor straight percentage leases unless the landlord knows his prospective tenant and has faith in his location. But to give a tenant under present conditions a six months trial is ludicrous. The tenant will not properly equip a store for so short a period, and without proper equipment he cannot possibly prove his ability to produce volume. I favor recapture clauses by the landlord under certain conditions as well as cancellation privilege to the tenant. The "rule of reason" should be the yardstick.

May I point out that while there are many advantages to the landlord in a percentage lease, there is one dominant benefit to the tenant. Under a proper percentage lease he pays a rental commensurate with his sales, whereas under a "straight" lease his rental may be entirely disproportionate to the sales. Rental is always governed by volume and when sales decline and rents remain constant there is trouble ahead. A tenant operating under a flat lease can in times of depression reduce all expenses and yet go broke on account of the rent. He cannot touch the rent except by agreement with the landlord, and some landlords just will not agree to reduce the rent. The tenant under a percentage lease trims his sales accordingly, and since his rent bears the proper percentage to his sales, he can weather the storm. To be sure, the tenant under a "fixed" lease may enjoy a cheap rental in boom times, but the tenant with a percentage lease is "insured" during depressions.

Assuming that the following conditions are met:

1. The tenant has capable management and necessary capital,
2. The business is suitable to the location and the space fits its requirements,
3. The type of business is not over-done in the locality,
4. Future competition will not materially affect the location,

let us summarize the essentials of proper percentage leases under present conditions:

1. A fair "minimum" guaranteed rental paid monthly.
2. The maximum percentage on sales that the particular business can afford to pay.
3. No "maximum" rental provision unless the guarantee covers carrying charges and the "maximum" provides a decent return.
4. No "straight" percentage lease unless owner has unbounded faith in the location and the prospective tenant.
5. No lease based on percentage of "profits" — there is too much room for disagreement there.
6. Landlord should receive monthly or quarterly reports of sales duly verified by tenant.
7. Tenant should be required to keep accurate books of account and landlord should have the right at stated intervals to examine them, or to make an audit.
8. Payment of the "additional" rental due to the percentage feature should be paid as the particular type of business permits.
9. Landlord should restrict tenant from establishing a similar store in the same locality and tenant should prohibit landlord from renting his adjoining property to competition.
10. Fair play — as in every transaction.

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Theoretical Versus Practical Appraising

By AYERS J. DU BOIS

IT is not uncommon for individuals of experience in a given field of endeavor to speak disparagingly of others in the same field whom they describe as being "theoretical." They have an utter contempt for what they are pleased to think of as "theory" and do not hesitate to express their feelings, the while priding themselves on being "practical" men. Contrariwise, the student in a given field, possessed of scientific understanding of his vocation, may also disdain the purely "practical" man—the one whose knowledge is limited to happenings within his own personal experience and not supplemented by scientific study and training. Are both the so-called "practical" and "theoretical" man taking unwise positions by such attitudes? Let us see.

What does the "practical" man mean by "theoretical"? Probably he and his fellows mean "impractical"—not possessed of knowledge and viewpoints of a useful or valuable character in actual practice, but rather possessing and advocating unsound and incorrect beliefs. Usually the epithet is applied by them to someone who has endeavored to explain things in a scientific way—i. e., from the standpoint of reason and analysis; and because the viewpoints of the so-called "theorist" are contrary in some respects to the conclusions which the practical men have arrived at through empirical knowledge but without careful analysis of their experiences, they scorn the opinions of the so-called theoretical man and ridicule him and his methods of practice.

But just what is the real meaning of this word, "theoretical"? The term "theory" has a Greek root meaning "to see," and "theoretical" might be literally interpreted as meaning the ability *to see—to discern*. To see or discern what? Facts—truth. In its best sense, "theoretical" means just that—"the ability to see (discern) and to explain facts through an understanding of certain ascertained governing principles." Thus a "theory" is simply an explanation of facts (real or assumed), or as Webster puts it, "The general principles of any body of facts; a general principle offered to explain phenomena, and rendered plausible by evidence in the facts or by the exactness and relevance of the reasoning." Therefore, a "theoretical" appraiser is, properly, one who, through a knowledge of the principles of scientific appraisal procedure and practice (which principles have been apprehended as a result of searching study and analysis of experience), possesses the ability to discover, interpret, and explain the facts in a given valuation problem. Such an one does not merit ridicule and disparagement.

Assumptions

Because some theories offer explanations based upon *assumed* facts, which are not *facts* but *falsities*, so that these theories are untenable and unsound, therefore, in the eyes of some "practical" men, *any* appraiser whom they consider to be "theoretical" is held up to approbrium and his opinions are declared to be untrustworthy. This is very unfair; it is like saying that because some "practical" real estate men do not understand the procedure in foreclosing a trust deed, therefore all "practical" real estate men are dumb; or because one ocean liner sinks, all ocean liners are unsafe.

Sometimes facts are assumed, and a theory, based on these assumptions, is applied in specific instances. If it is found that the theory is unworkable, then it becomes known as an untenable theory and the basic assumptions are proved to be false. All so-called "practical" appraisers are applying theories continually — that is, their methods are based upon certain assumed facts from which they evolve general principles. For instance, a very common assumption by "practical" appraisers is that the net earnings of apartment properties are constant in quantity, and their theory of valuation is to capitalize present net earnings in perpetuity. You see, whenever they capitalize the earnings, they apply a *theory* behind which are certain facts or *assumed* facts, although they do not recognize that they are applying theory, nor do they recognize the existence of certain hidden assumptions which they, in reality, are making. The "theoretical" appraiser will tell you that the earnings will fluctuate and will trend downwards as the building ages, and that therefore it is erroneous to value the property by capitalizing present net earnings in perpetuity. Which viewpoint do you believe is practical and correct? Is not the "practical" appraiser in this instance, really the impractical theorist, and the "theoretical" appraiser the practical appraiser? The latter applies principles of valuation based upon the facts of experience and practice; the former misinterprets the facts, substituting for them certain assumptions which he *believes* are provable by actual experience but which, in truth, are *erroneous* assumptions, so that the principles of valuation based upon them are also erroneous.

Every opinion of value results from the application of some theory of valuation based either upon certain facts or upon certain stated or hidden assumed facts which may or may not be true, or upon both such facts and assumptions. The danger in so-called "practical" appraising (that is, appraising based solely upon empirical knowledge and without a background of understanding of scientific principles and procedure) is that the appraiser makes certain assumptions without knowing it; and being ignorant of these hidden assumptions, he is not aware of the necessity of weighing them to see if they are true or false, in accord with reason and experience or contrary thereto; therefore he may be putting reliance on untenable theories, mistaken principles, incorrect assumptions of fact, and cannot avoid the consequent errors which will creep into his conclusions.

Examples

For example, here are some cases of hidden assumptions, mostly erroneous, but which, nevertheless, are the basis for the opinions of many so-called "practical" but unscientific appraisers:

1. A summation valuation assumes that cost and value are equal.
2. A straight-line depreciation of the improvements constituting an income-producing property assumes that the earnings of the building will decline in the same manner and proportion.
3. A direct capitalization of the earnings of a property assumes:
   (a) that the earnings will not fluctuate in the future;
   (b) that the earnings will continue perpetually;
   (c) that the improvements will last forever.
4. A straight or direct capitalization of the earnings of land at a particular time assumes that the land value will remain constant.
5. To say that one parcel of property is worth a certain amount because another parcel sold for that amount assumes:
   (a) that the two sites are equally desirable and possess equal utility;
   (b) that they are identical in their individual characteristics;

(c) that the same influences environ them and affect them equally in all respects;
(d) that sales price determines value;
(e) that the particular sales price was equivalent to the value of property sold;
(f) that no change in value has taken place since the sale was made.

6. To fix the earning capacity of a structure on the basis of existing rentals and tenancies therein, assumes:
   (a) that the rentals are fair;
   (b) that the rentals will continue without quantitative change.

7. To fix the relative values of two lots by means of a depth table assumes that the depth factors used express the relationship between the values of these particular lots.

8. To capitalize the earnings of all land at 6% and buildings at 8%, or any other single rates, assumes that there is no difference in the risks and hazards of ownership of various properties.

9. To determine the net earnings of property without making allowance for vacancy losses, repairs, recovery of capital invested in improvements, and management costs, assumes:
   (a) that the property will always be 100% rented;
   (b) that the buildings will never need repairs;
   (c) that the buildings will last forever;
   (d) that management services can be obtained free.

The list might be almost indefinitely expanded; but the above will suffice to indicate that the so-called "practical" appraiser, working without scientific knowledge, may be very impractical and highly theoretical in the sense that he relies upon untenable theories, and assumes certain falsities to be facts.

Two Cases

Two experiences will bring home to you the points made. The value of a certain apartment building was a subject of litigation. An exceptionally well-known "practical" appraiser of very wide and long experience, one who scoffs at such nonsense as "theory", testified that:

1. The value of an apartment house should be based upon the **actual** rentals being paid at a specific date, the date of appraisal;

2. It would make no difference in his opinion of value whether the rents had been higher or lower prior to the date of appraisal or subsequent to the date of appraisal;

3. It makes no difference whether tenants have leases or not;

4. Management had nothing to do with the amount of rentals obtainable because apartments speak for themselves and therefore the quality of management cannot affect the income.

Another very experienced "practical" appraiser with no scientific training testified that:

1. The only proper basis for valuing an apartment property was by estimating reproduction cost of land and building;

2. That earning capacity was not a guide to value;

3. That buyers purchased on a basis of replacement cost rather than earnings but that builders would be influenced by rents obtainable in deciding whether to build or not.

Another appraiser testified that the value of the land improved with the existing building was $250 but that if the site were vacant it would be worth $12,000. This testimony, I believe, resulted from the use of an untenable theory.

The other appraisers, whom the "practical" men would undoubtedly classify as "theoretical", testified that elements proper to be considered were: (1) replacement cost; (2) rental value, present and future; (3) existing scale of rentals; (4) existence or absence of leases; (5) terms of leases; (6) capitalized value; (7) comparative value; (8) recent sales, asking prices, restrictions, expected future changes in price levels, etc., etc.

QUESTION: In the above case were the "practical" appraisers *practical* or *impractically theoretical?* Were

the "theoretical" appraisers *practical* or *impractical?*

Another Case

In another case a self-denominated "scientific" appraiser testified how he applied scientific principles in valuing 40 feet of side-street frontage in the middle of a corner lot 200 feet deep:

1. He valued the lot as a whole;
2. By means of Somers Depth Table (designed for use only on inside lots, though he didn't know it) he calculated the value of each foot of depth of the lot;
3. He determined the value of the 40 feet by adding the values found for these particular 40 feet in step No. 2, result—$3,900.

Other appraisers with a grasp of truly scientific principles, testified how they estimated the value of the 40 feet by considering its potential earning capacity if properly improved; result—$6,000. The Court awarded $6,000 as the value of the 40 feet. The first appraiser mentioned was the "theoretical" type who merit the criticism of the "practical" appraisers; such theorists, however, would be better designated as "conjectural" appraisers.

The view-points of practical men, trained or untrained by study of scientific principles, are not to be regarded as worthless or necessarily unreliable; indeed, experience is an absolute essential to the rounding out of one's judgment. At the same time, theory cannot be excluded or omitted in enlightened appraisal procedure. Conclusions drawn solely from empirical knowledge may be unreliable because things are not what they seem: hence, the study and analysis of experience, leading to the formulation of theories whereby general principles can be discovered, stated, promulgated, and applied, is an essential supplement to empirical knowledge. We might liken the so-called "practical" appraiser to an automobile mechanic whose equipment consists of a hammer and a pair of pliers; with these tools he can do certain things satisfactorily; and the so-called "theoretical" appraiser (in the best sense of the term) might be likened to the mechanic whose tool kit includes all the special tools necessary in doing any mechanical work that is ever going to be required in his vocation.

Let us give credit wherever it is merited. Let us be willing to go forward regardless of whether the leader be dubbed "practical" or "theoretical"; but let us not follow leaders advocating untenable theories, whether these leaders be designated by the one term or the other. Let us recognize the worth and necessity of experience; but let experience go hand in hand with theory—sound theory—and become purged of the contamination of erroneous assumption. Let us welcome theoretical studies for they are made for the purpose of discovering, interpreting, explaining the true facts, and formulating general principles to guide us in learning the truth about the factors which create or destroy real estate values. Let us take the *versus* out of *practical versus theoretical appraising* and make it *practical theoretical appraising.*

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The Appraiser's Duties Today As To Value

By Francis K. Stevens

I CAN probably sum up my whole address in three sentences. Be honest. Use common sense. Do not forget the basic economic law of supply and demand.

In regard to honesty, I believe most so-called dishonesty in appraising has been committed by appraisers because they do not use the English language according to the dictionary and do not weigh their statements.

Take the word "value", which appraisers use all the time. It is a word expressing a general term and should always be used with an adjective to define its meaning. Appraisers use it generally as meaning "fair market value", which is the price at which a seller, ready but not forced, will sell, and at which a purchaser, ready but not forced, will purchase. But there is book value, reproduction value, cost less depreciation value, selling value, buying value, and as many other values as there are adjectives. Therefore, we appraisers, when we mean any other value than fair market value should be very careful to use the adjective before it. I have seen the word "value" used in appraisals of industrial plants with no explanation at all as to whether it meant book value, reproduction value, cost less depreciation value, or present day cost less depreciation, and thousands of dollars of securities I believe have been sold on the words "the property and plant has been appraised by so and so at so many dollars". Now we all know that there is a vast difference between what a going concern could obtain for its property and special machinery if sold to a willing buyer and what it could obtain for its property if sold at foreclosure, or for a purpose other than that for which it was built. In the latter case, much of the value of the machinery would have to be scrapped. There is no dishonesty in appraising property at its going concern value, or on the basis of cost less depreciation, or reproduction value less depreciation, or any other method, provided the appraiser clearly states the basis on which he makes his appraisal.

Common Sense

Now let us take up the question of using your common sense and applying it to the fair market values of today. In both extremes of a market the transactions recorded do not, in my opinion, represent the fair market value of the property sold, for in both extremes the parties are coerced by circumstances and are not free agents. In the so-called bull extremes of a market the purchasers are so anxious to buy that they remind me of a crowd trying to get on a subway train in rush hours, afraid that the doors will close and the train start and leave them. They ask the broker to purchase a piece of property for them. If the owner does not want to sell, they try to persuade him by raising their bids, and the owner realizing that values are going up is afraid to sell unless he gets what he considers is an exorbitant price. Therefore, you have an unwilling seller and a too willing purchaser; and vice versa in the bear extreme, the purchaser is reluctant to buy and the seller so anxious to sell that he gives his wares away.

Today we are looking back, I believe, not on the end of a bear extreme, but on the debris of a panic. Fear, probably the strongest animal force in the world, has been loose and

Mr. Stevens delivered this address before the Institute at the New Willard Hotel in Washington, D. C., on Friday, January 27, 1933.—Ed.

untrammeled. People became unreasoning in their panic, threw everything to the winds, and ran for safety which they thought consisted in exchanging their commodities for gold and hoarding it. It is not unlike what happens to a routed army in battle, where the soldiers throw down their arms and flee, not realizing that when they have come to their senses and are ready to return to the battle they will need the very arms they have cast away.

There being no fair market value in times like these, those of us in responsible positions, and I want to impress upon all appraisers that they are now in a more responsible position than they have ever been before, must take our responsibilities fearlessly and conscientiously and create a fair market value where none exists. Here is where our common sense comes in. We appraisers should not count the distress sales and foreclosures, or what some "harpie" (ready to gain from somebody's distress) will pay for a piece of property, as criteria of fair market value. These criteria are the corpses killed by fear. We must look to the living ones, those properties that have weathered the storm, for our guidance as to values. That there may be no dishonesty in such an appraisal an adjective should be used to describe that value. In my appraisals, I have chosen the word "reasonable", and I define that reasonable value as being the price below which I would not advise a client to sell his property if he was able to hold it and not forced to sell, and the price at which I could conscientiously advise a purchaser who wanted the property and could use it, to acquire it.

No Ready Market Today

Today we know that there is no ready market for any commodity. Take the stock market or the bond market. Prices are quoted daily, but certainly if we are unfortunate enough to own any of these securities we would not sell them at these figures unless forced to. If we have any belief in this country and its institutions, we know the prices paid today are far below the intrinsic and reasonable value.

Human nature, in my mind, is like "Alice Through the Looking Glass", for in a bull market and with inflated values people insist on buying commodities on the basis of two or three per cent return, and in a bear market will not touch the same commodities, although the return may be 10 or 20 per cent. In my mind, that is just the reverse of what it should be.

Average Returns

I expect my investments to average me over a period of years a certain per cent. In normal times the yield is that per cent. In inflated bull times the return would be considerably higher and in a subnormal market the yield would be less than normal. For example, if a property in normal times with a normal rental should yield $7,000 net, in 1929 it probably was yielding $10,000 net, and today $4,000 net. Therefore, I think we appraisers, after satisfying ourselves that the rentals of a piece of property have come down to their subnormal basis and that for the next year or so the property is reasonably sure of returning that amount, should capitalize that net return at, we will say, 4% rather than 10%. That would give a criterion of reasonable value. Now when I say per cent I am talking of the usual percentages in New York City, and you appraisers must not use my percentage as a rule for the country. If the normal percentage is 8 or 10% in your locality, then use that percentage rather than my 7%. I am only illustrating not laying down rules, and your common sense must be your guide.

The appraisers should bear in mind that return, always a strong factor in fixing the final value of a piece of real estate, is the most potent one now. A great majority of appraisers and officers of loaning institutions are influ-

enced unconsciously perhaps, by the fact that the owner paid so much for the land and the building cost so much, and therefore, its value must be the sum of these two. When asked what is the net return of the property, very often they say they do not know or have not considered it. Bad financing and the disregard of income is at the bottom of most of the real estate difficulties today. How can a piece of property earning a net return of 3% weather the storm when it is mortgaged at two-thirds or more of its value, and has to pay 5 or 6 per cent interest on the mortgage.

Non-Income Properties

What I have said up to now has primarily to do with city and income producing properties, and you may very well say that return does not apply to the thousands of homes occupied by the owners. Such properties, to be sure, must be appraised bearing in mind their duplication cost, but the ability of the owner to pay the taxes, interest, and amortization in normal times at normal salaries, is a very potent factor and that latter takes the place of income. The production of a farm can be measured and that gives it a value. The personality of the owner is, in my mind, also a dominant factor. More care should be taken in appraising properties than ever before and all factors should be considered.

It must be remembered that vacant property eats up its value in loss of interest and taxes very rapidly. But we want to bear in mind that it is not normal that wheat should remain at 45c or 50c per bushel and hogs at $2.75 per hundred weight and the other staples of life in like proportion. The earning power of the general public is not as great in dollars as it was in 1928 and 1929 but it is worth more than the present condition of unemployment indicates by a very considerable amount.

Another thing that an appraiser must bear in mind is that although today real estate taxes are in many communities confiscatory, the public is aroused and demanding that our public authorities, Federal, State, County, and Municipal, must stop spending the public's money and that eventually real estate will be relieved of some of the burden it is carrying now. Also that occupancy is at its minimum. Families are doubling up and in-laws living with in-laws to save expenses. Now as much as we love our family and our in-laws it is human nature not to live with them if we can live separately, and as soon as people get employment and begin earning again the terrible pressure of contraction will be relieved and almost instantly from being way overbuilt at the present time, the demand will catch up with the supply and a large part of the vacancy that is existing today will be wiped out.

In General

Therefore, it is up to us appraisers to establish from our experience, our knowledge, and our common sense, what should be the reasonable normal level, and base our valuations on that condition, disregard today's sub-normal conditions and remember that values in this country have never gone backwards permanently. They have had set-backs but each succeeding wave has been higher than the preceding one. The normal value line is not at the top nor at the bottom, but through the middle. Before you turn out an appraisal, mentally put yourself in the position of owning that property with reasonable resources to hold it, and say to yourself, "Would I sell that property for the figure I am putting on it, if I were not forced to do so?" Now that does not give the appraiser license to go unreasonably high, but it should deter him from going unreasonably low. That is, in my opinion, the duty we appraisers owe the public today.

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The Real Estate Cycle In San Diego, California 1900 to 1932

By JOHN G. CLARK

WHILE in normal times it is always interesting to study the history of business conditions, and to trace the swing of the business pendulum and its effects; in abnormal times, such as at present prevail, it is essential that we study the history of business in order that we may be the better able to form an opinion of what the future has in store for us. It is with this in mind, that the writer presents a short study of business conditions in San Diego, — 1900 to date, as applied to, and as affecting the real estate business and real estate investments.

It has been found that there are two groups of statistics which give the most accurate information and picture of the growth of the city. These are the records of the enrollment of children in the Day Schools and the Building Permits.

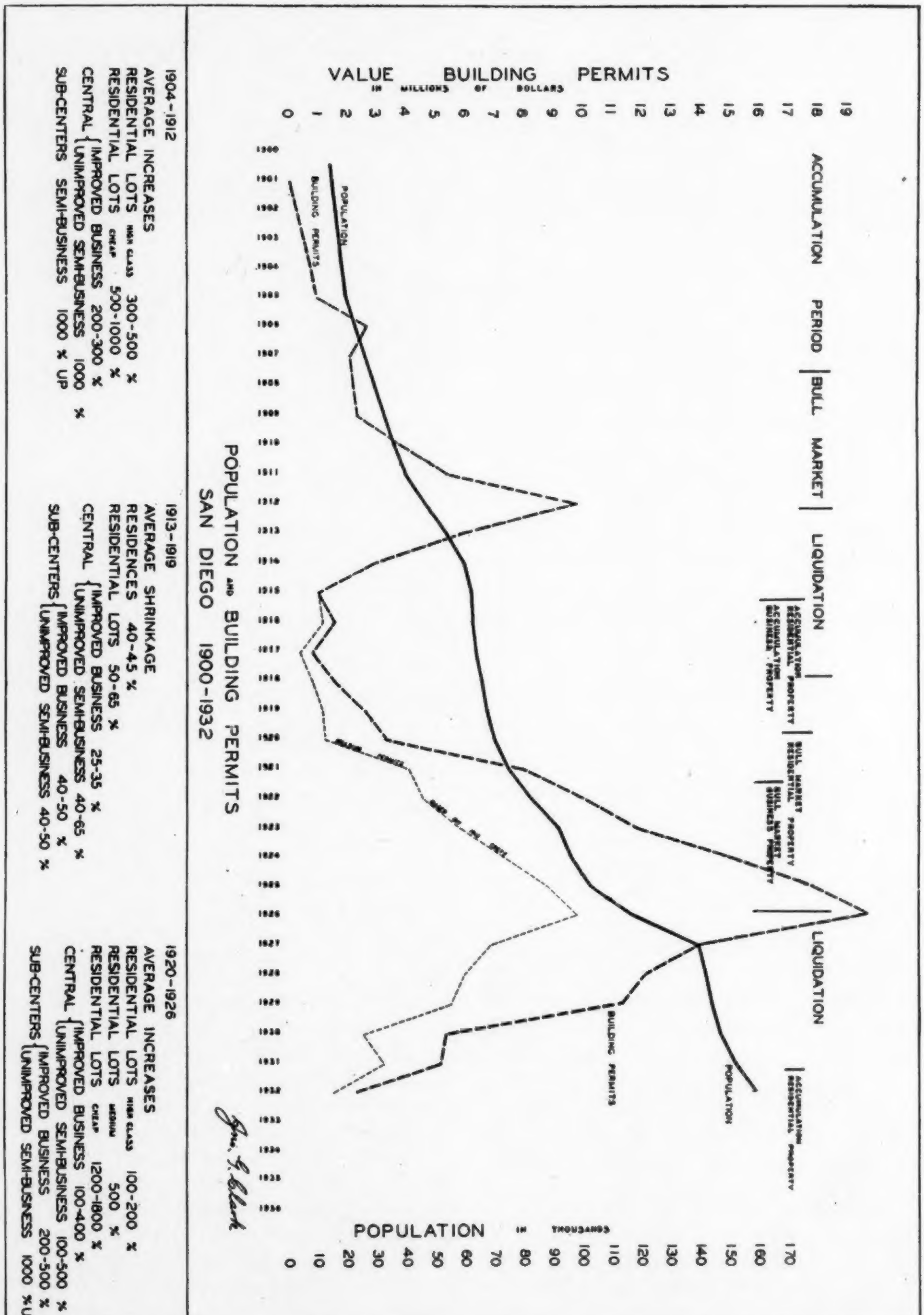
It was found that the ratio of population to the number of children enrolled in the Day Schools varies but a very small percentage from decade to decade, and that by using the figures of the number of children enrolled in the Day Schools, we can estimate the population of the city within a percentage of error believed to be less than one percent.

It is well-known that building activity and real estate activity are very closely allied; the record of Building Permits gives a much truer picture of real estate activity than even the record of deeds recorded at the Court House, or of lots platted for subdivision.

The accompanying chart gives the record of Building Permits in San Diego from 1900 to 1932, and also gives a line of population growth in San Diego from 1900 to date. The figures for the population as above stated, are based upon the enrollment of the Day Schools of the San Diego City School District, which includes the Kensington, Talmadge area, where there are now approximately 1,100 homes, and which the census of 1930 gave a population of 2,735 people.

Two Cycles Since 1904

This chart shows that since 1904 there have been four major swings in San Diego, or two complete Real Estate cycles. The first cycle covered the period from 1906 to 1919, during which we had a rising market from 1906 to 1912 inclusive, or seven years. This market topped out about March 1st, 1913, and hit bottom about the summer of 1919. The second cycle then began and ran until the Summer of 1926 when it topped out, since which time we have been in a period of lessened activity and falling prices. These two cycles have been broken up into different phases, which have been named according to the action taking place during these different phases. The period from 1906 to 1909 inclusive, is described as a period of accumulation. From 1910 to 1912 was a period of much faster growth, during which time real estate prices advanced very rapidly. We call this period a bull market in real estate. With the topping out of the market in March, 1913, activity in real estate slowed down materially, — prices began to drop rapidly, and liquidation set in. This period of liquidation continued, I think, to about 1917-1918, when prices of all classes of property seemed to hit bottom, and remained


POPULATION AND BUILDING PERMITS
SAN DIEGO 1900-1932
VALUE BUILDING PERMITS IN MILLIONS OF DOLLARS
POPULATION IN THOUSANDS
ACCUMULATION PERIOD
BULL MARKET
LIQUIDATION
ACCUMULATION RESIDENTIAL PROPERTY
ACCUMULATION BUSINESS PROPERTY
BULL MARKET RESIDENTIAL PROPERTY
BULL MARKET BUSINESS PROPERTY
LIQUIDATION
ACCUMULATION RESIDENTIAL PROPERTY
POPULATION
BUILDING PERMITS
1904-1912
AVERAGE INCREASES
RESIDENTIAL LOTS HIGH CLASS 300-500 %
RESIDENTIAL LOTS CHEAP 500-1000 %
CENTRAL IMPROVED BUSINESS 200-300 %
CENTRAL UNIMPROVED SEMI-BUSINESS 1000 %
SUB-CENTERS SEMI-BUSINESS 1000 % UP
1913-1919
AVERAGE SHRINKAGE
RESIDENCES 40-45 %
RESIDENTIAL LOTS 50-65 %
CENTRAL IMPROVED BUSINESS 25-35 %
CENTRAL UNIMPROVED SEMI-BUSINESS 40-65 %
SUB-CENTERS IMPROVED BUSINESS 40-50 %
SUB-CENTERS UNIMPROVED SEMI-BUSINESS 40-50 %
1920-1926
AVERAGE INCREASES
RESIDENTIAL LOTS HIGH CLASS 100-200 %
RESIDENTIAL LOTS MEDIUM 500 %
RESIDENTIAL LOTS CHEAP 1200-1800 %
CENTRAL IMPROVED BUSINESS 100-400 %
CENTRAL UNIMPROVED SEMI-BUSINESS 100-500 %
SUB-CENTERS IMPROVED BUSINESS 200-500 %
SUB-CENTERS UNIMPROVED SEMI-BUSINESS 1000 % UP

more or less stationary. This period of liquidation was marked by a severe drop in prices during the first six or eight months of 1913, the drop in many speculative classes of property, that is the unimproved properties, being as much as thirty percent in six months. From this point on, the drop in prices became less precipitate, so that during the last two or three years of the period of liquidation, the drop in prices was slight, although the market was very inactive. The turn in prices of real estate did not come until the latter part of 1919, and while some liquidation, or shall we call it foreclosure activity, continued even in 1918-1919, nevertheless we believe that it would be more correct to state that accumulation of improved residence properties and of business properties began as early as 1917, so that we find there was an overlapping here of the beginning of the Accumulation period, with the end of the Liquidation period.

The Up-Swing in 1920

This Accumulation period in the improved residential market which began about 1917, terminated abruptly in the Summer of 1920, when an extraordinary influx of settlers from the middlewest created such a demand for homes all over Southern California, that we believe it may be accurately stated, that within a period of three months the market price of the great majority of the medium-priced homes, doubled. At this period it was not uncommon for a house to be sold three and four times during a thirty-day period of escrow, each time at an advancing price. This condition was due to, and was warranted by the extraordinary low price level, at which houses had been selling up until the Summer of 1920. It was at this time that we had the extraordinary spectacle of homes being sold for about 55 percent of what they cost when erected a few years before, — and this in spite of the fact that the cost of construction in the Summer of 1920 was the highest ever reached in the history of the United States, — the price level of building construction at that time being 260 percent of the 1913 level. By this we mean that a house that along in 1913 would have cost $1,000.00 to erect, would if erected in 1920 have cost $2,600.00 to erect.

In view of this difference in building costs, it is plain therefore that the extraordinary activity witnessed in the buying and selling of homes in 1920 was warranted, and that the prices for which homes sold during this period were also warranted.

The activity in business properties did not begin until about 1922, or about two years after the first burst of activity in residential property, and it is interesting to note at this time that the years 1920-1921, which were years of severe financial depression in the country as a whole, were not years of depression in real estate in San Diego, but marked the beginning of a prolonged period of growth with its noncommitant real estate and building activity. When it was found along in 1921 that the increase in population had been sufficient to absorb all the vacant houses, flats, and apartments in the city, and create a real shortage in housing facilities, construction activity began, slowly at first, but with an ever-increasing momentum. This construction activity naturally created a demand for building sites, and the distressed building lots began to disappear from the market. It was at this point of 1921 that the lowest level of prices for vacant lots was seen. In a short time however the market was swept clean of distressed lots, and the builders were then faced with the necessity of paying increasing prices for lots, which they promptly began to do, as they found that they had a ready market for homes that they might erect on these lots. This period marked

the beginning of the period that we designated as the bull market. There is of course a period of overlapping of the Accumulation Period into the so-called Bull Market period, for during this period of the bull market, people were constantly purchasing property either to keep for long time investment, for use as homes, or for speculation.

Subdivision Activities

This next phase of the bull market period witnessed the beginning of subdivision activities in the city. This began in 1923, but got under good headway in 1925. Contrary to public opinion this period of subdivision activity was not prolonged, and with but three or four exceptions, was not excessive. It is interesting to note that during this period from 1920 to 1930, when the city of San Diego increased in population almost 75,000 people, that the number of lots subdivided and put on the market in the so-called Metropolitan area, which includes subdivisions as far out as Rolando and Valencia Park, totalled only 13,151 building sites, and during this period over 22,500 building sites were absorbed in the erection of new homes, flats, apartments, etc. In other words, during this ten-year period many thousands of lots that were subdivided during the 1910 to 1912 market, were finally put to use as home sites.

Sub-Centers

During this period we also witnessed the growth of several suburban sub-centers, such as the 30th and University Avenue district, East San Diego district, Carteri Center, Goldfinch and Washington, and several others; and the latter part of this period witnessed the beginning of development of business on El Cajon Boulevard. The surge upward of prices for lots on University Avenue, El Cajon Boulevard, Adams Avenue, and other through thoroughfares, was about one of the last phases of the bull market. In the down town business district, activity in building was not marked until about 1925-1926, and the erection of large buildings in the down town area marked the last phase of the building activity.

It is interesting to note that during this entire period of the bull market very few hotels or apartment houses were erected in San Diego. This unusual condition was due to the fact that the city was considerably over-built in anticipation of the Fair in 1915, and it had a generous supply of hotel rooms and apartments. However the principal controlling factor, was the high building costs prevailing at this time, which made it, in fact almost impossible for any one to erect a hotel during the period, and compete with the hotels erected at pre-war costs.

The reader's attention is now directed to the accompanying table, which classifies the different phases of the cycles, and shows the percentages of increases and decreases in values during these cycles:

During the first major upward swing 1904-1912, it was found that values increased about in the following percentages:

Residential Lots, Cheap Districts	500%-1000%
Residential Lots, High Class Districts	300%- 500%
Improved Business Properties	200%- 300%
Unimproved Semi-Business Properties	1000%
Sub-Centers	1000%-up

During the Liquidation period 1913-1919 the average shrinkages were about as follows:

Residence	40%-45%
Residence Lots	50%-65%
Improved Business Central	25%-35%
Unimproved Semi-Business Central	40%-65%
Improved Sub-Centers	40%-50%
Unimproved Business Sub-Centers	40%-50%

During the rising market 1920-1926, we find the average increases were about as follows:

Residences	100%- 250%
Residence Lots—Mission Hills, high class	100%- 250%

Residence Lots—North Park, medium high class	500%
Residence Lots—Normal Heights, cheap class	1200%-1800%
Improved Business Property—Central	100%- 400%
Improved Business Property—Sub-Center	250%- 500%
Unimproved Semi-Business—Central	100%- 500%
Unimproved Sub-Centers	1000%-up

Since 1926

We now come to the period from 1926 to date: This period of declining activity and prices was not marked by a sudden and severe slump in prices that witnessed the beginning of the bear market in 1913. Activity subsided rather gradually, and was in fact marked by a declining activity in some sections, while other sections were having quite an active market. This was to some extent due to the plethora of mortgage money available at this time. The activity continued in the Kensington-Talmadge area, and in parts of Point Loma and possibly other districts, after the activity in many other sections had subsided considerably. The drop in prices continued to be rather slight throughout the years 1927-28 and 29, but began to be severe in 1930-31 and 32, until at the present time, in many cases, improved and unimproved properties are selling at ridiculously low figures. In fact, in many cases, home sites, apartment house sites, and even business properties are selling for less than the same properties were worth in 1911, in spite of the fact that during this period the population of this city has increased from 40,000 people, until at the present time our population including the Kensington-Talmadge area, approximates 162,000.

The time element in these cycles were as follows:

1906-1912	rising	7	years
1913-1919	falling	7	years
1920-1926	rising	7	years
1926-1932	falling	7	years

During this entire period of the bear market, we have had a constant diminution of activity in the building of homes, and the complete cessation of subdivision activity. However during this period the population of the city has constantly increased from year to year, with the result that each year there has been a constant absorption of the excess supply of homes, until today, it is believed that if we did not have families doubling up, that is two and three families living in one home or one flat, we would have in San Diego today a real shortage of housing facilities. In fact, a shortage of desirable homes is even now being reported.

Thus we realize that the ground work is already laid for the next swing upward, which will mark the first leg of the next cycle in San Diego real estate activity. When this will start, depends upon how soon national business conditions come back to normal. There is one thing of which we can be certain: for the thrifty, careful buyer, we have undoubtedly entered another period of accumulation.

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Management

By NATHAN LIBOTT, M.A.I.

SKILLFUL management is exceedingly rare; but, when found, is precious indeed. The line of demarcation between genius and madness is hard to define; and the line between successful management and failure is no less finely drawn.

If you expect to find here a definite percentage chart showing various values of management you will be disappointed. I know of no table nor of no chart that has been or can be worked out which gives any help in that direction.

Management is a human equation, —and as such must be weighed by the appraiser in arriving at his final analysis of value.

There is no substitute for judgment, there is no substitute for knowledge, there is no substitute for experience. In order that you may give management its true ratio, you, as an appraiser, must combine knowledge, experience, and judgment. All we can hope to do today is to try to gain knowledge through experience, as outlined in specific examples.

The value of management in any enterprise — be it rolling mills, automobile factories, tanneries, hotels, apartment houses, or what not, is directly reflected in the net return. Management is responsible for increased net return in the following ways:

1. Through decreased cost of operation, the income remaining stationary.
2. Increased income and decreased cost of operation.
3. Increase in operation cost, but a larger increase in income, in which case the added expenditure is both justifiable and advisable.

Let us first look into the subject of apartment houses. How and to what extent are they affected by management?

A furnished apartment house is built for the sole purpose of producing a revenue from renting furnished apartments. It's that kind of an animal. If we try to divide it, we have a business and we have real estate, where actually we should have — a furnished apartment.

Is it not a fact that most apartment houses are owner-operated? And if this be a fact, and if we are able correctly to analyze the costs of operation, and the cost and value of management, is not the resulting sum the earning capacity of the property?

The trouble has been that the owner figured only the money he actually spent, and nothing for his labor (either mental or physical), and nothing for the risk involved.

Another source of trouble has been that in boom times so-called appraisers took the revenue for granted in perpetuity. In times of depression they take the lowest possible income, the highest vacancy factor, the largest depreciation, — and then an added percentage for good luck in order to be safe.

A doctor in examining a patient listens to his heart, his lungs, takes his blood pressure, etc., and if there are no aches or pains, and if the result of his examination brings forth no definite signs of trouble, says, — "You are fit as a fiddle. Come back next year and I'll take another look at you." If, however, his trained ear hears a murmur of the heart, or a rattle in the lungs, he says, — "Wait a minute — there undoubtedly is something

wrong. We had better have a fleuroscope and an X-ray, and quantitative and qualitative analysis, so that we may find what (if anything) is wrong."

I believe that in analyzing the value of an apartment we, too, should follow the same process. If everything on a thorough examination looks all right, then we can base a logical opinion on our findings, but if something is off — then it is up to us to find out the what and the why.

Typical Cases

Have you had this experience? You enter the lobby of an apartment house at 10 A. M. The property represents an investment of upwards of three hundred thousands of dollars, and has apartments renting for three hundred and fifty dollars per month. You ring the manager's bell; and a middle-aged man, dressed poorly as well as making no pretense of cleanliness, answers. You are told that the manager is out shopping and will be back in a few minutes, and are invited into the apartment to wait. The apartment is furnished not in keeping with the lobby, but as befits the home of a twenty-five dollar per week workingman. After a half hour wait the manager finally arrives. She is carrying a large shopping bag filled with vegetables and groceries; and, astounding as it may sound, is wearing a chiffon dinner dress and high heeled slippers with rhinestone buckles.

Perhaps you have met the manager who believes that she must *sell* the prospective tenants, and that salesmanship consists of a continuous volume of sound. Or, perhaps you have met the manager who drags you to a closet window because it has a view, and the only view, of the hills or of Catalina. Or who shows you an apartment that has not been dusted, where the faucets are leaking, and garbage cans are out in the hall at noon. Or the one, who seems to have twice as many maids as are necessary; or the one who trys so hard to know everybody's business. There are many, many types. When the appraiser meets them, — they are immediately a warning to him that his problem must be studied thoroughly.

In the first case mentioned here the manager received an apartment and a percentage for all apartments that she rented. A thorough analysis later convinced the owner that he could better afford to hire a manager at a good salary. The new manager was a woman of culture and refinement. She was smartly dressed and made the prospective tenant feel that he was being welcomed to the atmosphere of a fine home. Is it any wonder that the net return was increased by one thousand dollars per month?

In appraising a certain apartment building, you find that the rents are below that received for similar properties in the neighborhood. You ask yourself why, and are unable to find a satisfactory answer. The management is capable, the tenants are satisfied, the service is good. And you may find, — as I did, — that an apartment renting for seventy-five dollars per month was on the books at fifty dollars. The difference in income represented a loss of two hundred dollars per month. Since that time, I always find out whether or not the manager is under bond? If not, I contact a certain number of tenants and verify the actual rents.

Here is another actual case: Again a high grade building, a beautiful setting, and a reputation for being a smart place in which to live. Flawless service and outrageous prices. The manager is exceedingly capable, but unfortunately dies. The new manager has a rental loss by vacancy of 25% of the gross within six months. A change of management, and the vacancy factor within sixty days is back to where it was under the original management.

None of these cases, mind you, are figments of my imagination. Each one is an actual experience. What, I ask you, is the value of management?

Office Buildings

Office buildings usually represent large investments; and, therefore, we might presume, have reasonably capable management. But what a difference there may be!

A class "A" steel and frame building, well-located, finds after nine months of operation that it is 80% rented, and yet has piled up a deficit of $140,000.00. Part of this, or approximately $60,000.00, represents capital investment. A change of management, and within three years the deficit is wiped out and the building is on a paying basis.

Another similar building: In this case the owner believed that offices rent themselves, and that anybody could handle janitors, elevator operators, buy supplies, etc. He therefore, placed an inexperienced, poor relation in charge. Six months of this type of management produced a net loss of $75,000.00. A change of management was then made; and, after four years of operation, the building was on a paying basis, with the original loss wiped out.

Here is another case: A building containing about 90,000 square feet was after eight months 4% leased on a basis of $1.00 per foot. An experienced management organization then took the building over, decided to change the type of occupancy, and created a combination showroom and warehouse for manufacturers' representatives. The estimated return was $1.75 per square foot. Forty-three per cent of the space was leased within thirty days. When the building was 87% leased the actual return was $1.69 per square foot.

One more example, if you will: A loft building in the downtown district. Owners tried hard to obtain tenancy and finally succeeded in leasing 14% on a basis of four cents per square foot. The building was placed under a management organization. The floor plan was completely revamped, the exterior altered for attractiveness, the entrance changed over, and a lobby installed. In order to get this lobby it was necessary to do away with one store 20x150 feet. The manager conceived the idea of placing lighted display cases in the lobby, and rented the cases for enough to pay the cost of maintenance as well as rental for store space. Within 6 months the building was 62% leased at the rate of seven cents per square foot, as against the original 14% at four cents. The entire ground floor was leased within nine months. What, I ask you, was the relation of this type of management to the value of this property?

Business Property

Business property is usually acquired on the opinion of the individual purchaser, supported by the mass opinion of the butcher, the baker, and the candlestick maker. The property is then left to manage itself. Anybody can collect rents, and pay the water bills, and put up a "for rent" sign. Anybody can draw a new lease. In a rising commodity market, values continue to go up, and the purchaser makes a profit which may or may not represent unearned increment. Said owner now is an authority on the value of real estate, and an expert on the subject of management as applied to business property.

Billions of dollars of investment in small business blocks all over the country are handled in this manner. The unusual case is the one in which a property is handled by a competent organization or individual who has the brains and the ability to analyze his commodity. New problems in management are continually arising and are properly handled only in isolated cases.

The great problem of management in business property today, in my opinion, is the question of percentage leases.

Theoretically, percentage leases are based upon good sense,—justice to tenant and landlord,—and are the acme of simplicity. Actually, they are as complicated as the Einstein Theory of Relativity (which I don't understand).

Percentage leases are not new. But the fact that today the small individual merchant as well as the national chain store insists upon this method of rent computation, is new. In times past, many owners would have been vastly benefited to have had percentage leases. In the future, more and more leases of this type are going to be written. This very fact will bring new problems to the appraiser, some of which we shall mention here.

In a flat percentage long-term lease, the owner of the property is dependent on the following:

1. Financial stability of the lessee.
2. Business ability of the lessee:
   a. Present management.
   b. Possible changes of management through death of executives, sales of controlling interest, etc.
3. Honesty and integrity of the Lessee.
4. Economic changes.
5. Competition arising from other firms:
   a. Those already in the territory.
   b. Those who may enter the territory.

Each of the above will directly be reflected in the income the owner will receive, and over none of which will he have any control.

Illustrative Cases

Let us take a few concrete examples: An individual has operated a drug store very capably, and on a percentage basis has paid over a period of six years an average of seven hundred dollars per month. He sells out to a large chain, and during the balance of the lease the rental drops to three hundred and fifty dollars per month. Investigation discloses that the change of management was responsible for the drop.

A building in a certain city has been rented to a tenant for ten years. At the expiration of the lease, the tenant goes to the owner with the proposition that his concern is putting all of its stores on a percentage basis. The tenant says, "Your rent has been four hundred and fifty dollars per month. Our business can afford to pay ten per cent. Our average sales have been over five thousand dollars per month." A new lease is negotiated. The rental return drops to an average of one hundred and fifty dollars per month. Investigation disclosed that sales made by outside salesmen are now delivered direct from the warehouse. Naturally this does not appear on the records of this store.

This is not an isolated case. I could quote any number of cases of sharp practice where the owner has suffered. It is necessary for the owner to have some kind of an audit periodically, and this is an added expense of operation. A great many schemes are being continually devised to get around the payment of the agreed percentage. From the standpoint of the owner there is no certainty of a definite return.

Two stores are located in a single building. Both are leased for ten years on a flat percentage basis. Each store is capably managed, and, so far as can be determined upon investigation is, getting a full share of its business in the territory. One store is occupied by a cut-rate drug chain; the second by a ladies' ready-to-wear. The drug store pays a return of three hundred and fifty dollars per month; the ladies' ready-to-wear, one hundred and twenty-five dollars per month. Similar stores in the territory are leased on a basis of two hundred dollars per month. Need I point out further the many, many problems which arise in the evaluation of this property? Is the

one hundred twenty-five dollars a correct basis, or is three hundred fifty dollars a correct basis? Will the one increase, and the other decrease?

An uptown business center has one five and ten cent chain store. The district develops, and another chain enters the field. Both stores do exceptionally well. Soon there are eight chain stores in the same general classification. The district is not increasing in population, and the purchasing power of the inhabitants is diminishing. The gross volume of some of these stores is not up to their expectations.

A national organization came to an owner in this district and said: "We are the XYZ Corporation; we have $20,000,000 worth of assets, and no liabilities; we want to rent your property for a term of 25 years. You are asking $15,000 per annum as a flat rental for the next five years. Our survey and past experiences indicate that we will do a minimum business of $400,000 during the first year, and we will pay you five per cent of our gross sales. Our business always increases, and your income will be equal to whatever the property can earn. We will guarantee no minimum amount, and we will not allow any recapture clause."

The many intricate questions which this involved needed the serious consideration of a keen, analytical mind, trained in the handling of real estate problems. The unusually capable manager of this property, after a thorough study, turned the tenancy down, because the risk to the owner without some form of protection was too great.

Back in the good old days when a building was built in a neighborhood center, the owner always looked for a grocer, a butcher, a baker, etc. Then, followed the beginning of the modern grocery chain. Cash and Carry put the individual practically out of this line of business. Chains became city-wide, state-wide, nation-wide. If an owner had a chain store tenant, he said—"This much of my income is sound."

Super-Markets

Then some clever individual conceived "Drive-in-Markets". Automobile parking being an ever-present problem, they met with a definite measure of success. Next, we find the super-market of today. A new problem that is changing the value of thousands of parcels of property.

I have no way of knowing just how many individual and chain markets have closed in the past year. I do know this, however, that one chain which operated four hundred stores in Metropolitan Los Angeles has closed 119 stores in 1931. Another chain is demanding an arbitrary cut in rent of 50%.

Super-markets in themselves are not new. Their present development and application is new. They bring to the outlying centers a combination of easy parking facilities and cut rate prices. Under present economic conditions this spells a tremendous volume of business. When this business is paying rent on a percentage basis it leads us to some more interesting appraisal problems.

A super-market that has been in operation for about one year shows this kind of set-up:

Present replacement value of land $50,000.
Value of building $25,000.
Net income per month $2,700.
Annual net income $32,400.

Sounds almost like the original miniature golf courses. Yet, this is an actual case. Meanwhile, twelve individual and chain markets have gone out of business in the immediate vicinity.

In a city in Southern California a vacant corner was leased in 1920 for fifty years at a flat rental of three hundred dollars per month. The lessees in 1921 built a market building at a cost of $22,500, which was opened

for business in September, 1921. All tenants were on a monthly rental excepting one department which was on a flat percentage basis. Here is a history of the rent paid in the same two months of each year by that department, operated under the same ownership and management during the life of the building. Carefully note the distinct and decided decline.

Oct.	1921	$2332.17
Nov.	1921	1462.38
Dec.	1921	2182.23
Nov.	1922	1332.37
Dec.	1922	1500.12
Nov.	1923	813.43
Dec.	1923	1235.71
Nov.	1924	673.16
Dec.	1924	379.01
Nov.	1925	645.09
Dec.	1925	576.58
Nov.	1926	621.23
Dec.	1926	408.51
Nov.	1927	320.30
Dec.	1927	358.21
Nov.	1928	316.18
Dec.	1928	274.78

You will note that the rent dropped from $2,300 to $275 per month. While this decline in income took place, the city grew from a population of 40,000 in 1920 to 150,000 in 1928. Another interesting fact: taxes on this property in 1922 were $1,454.85; in 1928, $4,766.23.

History is a great teacher, if we would only profit by the experience of others. I quoted this case because I believe the analysis of this and similar properties will give us the working basis on which to base our judgment of a property that at the moment is showing a net return out of all proportion to its replacement cost.

I have tried to obtain authentic figures on how many super-markets have been erected in Los Angeles in 1931. I regret that I am unable to give them to you. I am informed by a source that I believe to be reliable that there are either operating, or in the course of construction, thirty-eight so-called super-markets West of Vermont.

There is no question in my mind that two things are taking place:

1. Supercession by obsolescence as applied to the neighborhood store buildings. The average owner who manages his own property, or has his nephews, uncle, or niece manage it, does not know what this term means.
2. Ruinous competition between the new super-markets is on the horizon.

Originally, the owner of a super-market rented the space with a minimum guarantee plus a percentage. The tenants paid for their own fixtures. The next step: Mr. Owner paid for the fixtures. Now, they are leased on a lower percentage, meats at 2½ per cent instead of 3½ per cent, groceries as low as 1½ per cent.

Specials are quoted below cost to attract the housewife. One market advertised a center slice of ham at one cent, with a limit of two slices to a customer. Three lines of purchasers were waited on all day, for while there was a limit to the amount, there was no limit to the number of times you could get in line. Below cost specials are now advertised with a purchase of fifty cents or one dollar.

Super-markets that have done exceptionally well are facing competition. I know of one directly across the street from another. A third is being erected a half block away. I know of another being erected within a block of one that has only been opened for less than six months.

I might give you another concrete example. A unique market was completed in 1930. It was leased on the following basis:

Meat department: Minimum guarantee, $150 or five per cent of the gross.

Groceries: Minimum guarantee, $150 or 3½ per cent of the gross.

Delicatessen: Minimum guarantee, $50 or five per cent of the gross.

The other departments were leased on a flat rental basis.

The income during the first seventeen months from these three departments was $9,613.88, or approximately sixty per cent over the minimum. A super-market was erected within a

few blocks, and beginning on the 18th month the minimum was never reached. Nine months later here is the picture: The meat department is doing a gross business of about $2,200 per month as against $5,300; the grocery and delicatessen have been combined and are now doing a gross business of $2,900 as against $9,000.

How long these merchants can and will continue to pay their guarantee is a question.

Some Points to Consider

This example, as well as the one quoted formerly, is the light of experience by which we may be guided in working out the value of a property which on a percentage basis is showing a net return out of all proportion to the intrinsic value.

I know of one owner who has sixty per cent of his property vacant at present. He has had some unfortunate percentage lease experience. He could lease every foot of his holdings on a percentage basis within a week, but he is holding out for a fixed rental basis.

There are a number of very capable men who are giving a great deal of time and attention to the question of percentage leases. Flat percentages, minimum guarantees, recapture clauses, all are being studied. What is the correct percentage for a shoe store, costume jewelry, drug store, furniture store, musical instruments, electric refrigeration, and all the other types of business? Can a shoe merchant on Whittier Boulevard pay the same percentage as one on Wilshire Boulevard? Does the owner want a percentage lease of any kind? If not, can he lease his property?

What effect will a percentage lease have on the renewal of a mortgage when it comes due? Will the holder of a mortgage, or a prospective purchaser, figure income based on the actual return, on the minimum guarantee, or on the prospects of the tenants, either up or down?

I personally am not in favor of a percentage lease for a long term which does not contain a safety factor for the owner. This factor of safety should be either in the form of a minimum guarantee or a recapture clause.

What the amount of guarantee should be as compared to a flat rental, or what the percentage for the particular business should be can only be decided after study in each individual case. When and how a recapture clause should operate, must also depend upon a careful analysis of all the facts involved.

Is it not obvious therefore that the many problems of neighborhood and outlying business property call for scientific management,—management unquestionably superior?

I have quoted actual cases, and tried to show you how important management is. What is its exact relation to value? I do not know. Nobody knows. Each individual property is different.

No two human beings are exactly alike. This fact does not stop the expert diagnostician from finding out what, if anything, is wrong with you. If you are a qualified appraiser, you must find out what is wrong with a property, if anything is wrong. Any person capable of doing simple arithmetic can measure the size of a building and say so many square feet times such a factor equals so many dollars. That is not appraising,—that is mechanics.

You must be able to diagnose. You must be able to analyse. You must be able to combine knowledge with understanding, and in the light of past experience form an opinion based upon ordinary common sense. Then, and only then, will you be able to evaluate management.

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Building for the Ages

By HARRY G. C. WILLIAMS

IF we look back over the time of the depression, it might be a fair statement to say that much of the depreciation has been due to faulty appraisals on the part of the owner, construction man, or the builder. Many buildings were constructed at prices which could not be maintained, and others through obsolescence show today a loss to the owner. A part of this loss may be overcome with any normal increase in activity or improvement in values. Other properties which today are obsolete, had they been given proper thought at the time of their erection, would still have greater value.

It does not seem to mean anything to the people of America that in London at the present time people are regretting the fact that well-built buildings, built two hundred years ago, are now to be torn down. We cannot prevent obsolescence, — in fact we would not wish to do so, as it is the outstanding mark of human progress; but we should prevent waste. As people progress to higher standards of living, they naturally demand greater comforts and conveniences. I cannot deny that well-equipped factories taking the place of old factories have increased the output of production and have improved the public health, but from the viewpoint of real estate, many buildings which could have been properly remodeled were needlessly torn down. In our large cities there are also residential properties which can be remodeled, but I must also admit that there are some which are entirely worthless and ready to be demolished before the ground will produce its best returns.

Because of inventions and science, the condition of the country is in a constant state of change. The law of supply and demand is of supreme importance and is based entirely on the instincts and desires of the average man. Where needless waste exists and obsolescence occurs it is most timely that we should give some thought and action to the subjects. We should approach the subject with a firm belief in the fundamental value of real estate; it is the basic wealth of our nation, — let us not waste it. Let us bear in mind that any construction on the land should be of such a nature as to return to the owner not only income annually but a safe return of principal as well. Anyone who devotes thought to the subject must today take a broader view of community interests and activities—City Planning—if you wish to call it so—is very real.

The public is insisting upon the best buildings possible. They look on old properties as being *old*; they fail to sense the value which could be gained through rehabilitation, and much education along this line could well be carried on by the Realtor. A little paper, a little paint, a little modernizing could save millions of dollars in value if applied at the right time.

It is the duty of the Realtor to take a forward lead in advising the public that this is the best time to make improvements; that materials and labor purchased at reduced cost will go much farther than the same purchased at high values.

Importance of Expert Advice

Knowledge of values, intrinsic or relative, is as essential to the Realtor in preparing a prescription for his real

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Mr. Williams delivered this address before the Institute at the New Willard Hotel in Washington, D. C., on Friday, January 27, 1933.—Ed.

estate client, as ability to diagnose disease is to the family physician. And just as truly as there is need in the practise of medicine for an expert consultant whose services may be available for both physician and patient, so in real estate the certified appraiser is essential to the Realtor and his client. The fundamental in a prescription for the body whether to maintain it in health, to aid nature in its recovery from ailment, to designate an immediate and perhaps heroic operation in a crisis, is ability to diagnose the true cause of the affliction. Consummate skill in prescription and operation is futile unless the diagnosis is true. So, when real estate is sick — as it long has been, though recovery unquestionably is evidencing itself — an appraisal is vital whether such appraisal is given merely as a prescription for a slight ailment or is an order for a major operation. The skilled diagnostician may prescribe medicine, operation, or merely a change of diet or of surroundings. The appraiser likewise is qualified to prescribe a major operation like complete reconstruction, or a minor one like a renovation, or a change of use and treatment.

Overcoming Depreciation and Obsolescence

In one way or another, man must be housed. And now seems to be the right time to give careful thought to the most desirable and profitable ways of housing him, not only in his home but in his workshop, office, and factory, so that depreciation and obsolescence may be gradually overcome. This should be the outstanding thought of any new building program. Buildings should add value to the land. Only suitable buildings represent the best use to which that land can be applied. Many buildings have been constructed in the past which have added no value to the property, and cost good money to tear down. I might even say that the best building is the building which has a value for all times.

We, in our humble way, look upon the life of a building as being from twenty to forty years and feel proud of our accomplishments; but in former civilizations, let me remind you that some of the most wonderful pieces of architecture stood the test of centuries. In our own land there are buildings, erected in the time of the American Revolution, which are as firm and strong and beautiful and desirable today, if modernized, as they were the day when constructed. I am not only referring to magnificent, large estates such as Mt. Vernon, the home of George Washington; Independence Hall, the outstanding landmark of America; but, if you will pardon the personal reference, may I say that I live in that old historic town of Germantown and I could point out to you there many houses of a very humble type, which are prized for their firm construction and their artistic beauty and which are already 200 years old. They were built by the hands of skilled craftsmen who took pride in their work and have given to the occupants of these houses over many generations comfortable and attractive homes in which to live.

Can we say as much for the builders of the "Civil War era" or even the "90's," or those of the "Recent Boom," many of whose houses are of a trick style of architecture, which does not lend to modernized alteration or improvement, and which, when the expense of tearing them down is considered, will not pay enough salvage for the demolition? I am not saying that there is much of this style of unsightly property; I am leaving that to your own observation, because what pleases one man may not appeal to another.

Some Influencing Factors

Time will not permit me to point out the various items which make

property valuable or invaluable from an obsolescent standpoint. There are certain fundamentals of good housing which have come down to us through the ages; and it is my personal belief that any deviation from good taste and substantial materials — no matter how catchy to the eye — is not *building for the ages.*

Of course, depreciation is natural wear and tear, but most depreciation can be corrected by making the necessary year to year improvements. Obsolescence, however, is a complete change of design, the discarding of certain building materials, or the fact that desirable locations suddenly become undesirable. This is a more serious question. Many of our families today with automobiles prefer living in the suburbs. This has caused some city properties, although well constructed, to become obsolete. A change in marketing areas is an important factor in obsolescence of residential property. The housewife of today demands accessibility of stores. Main Street in the big city has become too far away and the neighborhood produce man, the grocer, and also the druggist are coming into their own.

An outstanding educator has recently told us that 59 per cent of our families have no children under 10 years of age, and that 39 per cent have no children under 21 years of age. So we can readily see why there has been a migration from the individual house to the flat or apartment. In many families, all members of the family are employed in some gainful occupation, so that houses that were formerly used 24 hours of the day are now used only at night and totally deserted during the so-called working hours. Many of our builders, losing sight of this fact, have constructed houses totally inadequate to meet the needs of the people, and then wonder why they remain unoccupied. Any mistake on the part of a builder is a serious mistake when we consider that between five and six million of our people are engaged in one way or another — directly or indirectly with the building industry, and that one-quarter of our entire population receive — directly or indirectly — a substantial part or all of their income from building construction. The builder who prides himself on making a little extra profit by getting more houses on a piece of ground than it can adequatly carry will not, in my opinion, be a competitor of the conscientious builder in the future, now that land values all over the country have become somewhat reduced.

Methods of Appraising

Many of our appraisers have for years prided themselves on a set rule —"The value of the land plus the cost of the building" is supposed to be the value of the property. I will not attempt to show in detail how far this rule has gone astray, but I wish to point out that there are buildings, particularly one-purpose buildings such as clubs, factories, and certain stores constructed to please the personal whim of the original builder, which should not have been erected in the first place.

Other appraisers have for generations based their appraisals on the so-called "income basis". The rapid change caused by the business cycle both in the value of the dollar and reduced rents has caused this system to become very misleading.

When I first started the study of real estate I found in such text books as then existed (and there were only a few) a phrase running something like this: "Depreciation of a building is usually offset by an increase in land value." In fact I might say that I do not believe the word "obsolescence" was known at all, and if it were, it was seldom referred to. Today we can point out hundreds of well-constructed buildings where there has been

practically no depreciation whatever; there has also been no increase in land value, and yet through obsolescence — such as change in location — are now ready to be torn down.

Supply and Demand

The Realtor today should be more than a man who sells real estate; he must study his changing valuations scientifically over a long period of years. We are handling a commodity requiring considerable investment. Every element of loss should be reduced as far as possible. We should meet demand just as any other merchant selects the articles which people require. Supply and demand are the fundamental basis of our business. The world never moved faster than it is moving today; and the best results can only be produced by men of long term vision who aim for construction which will be attractive, livable, and likable to the next generation. Other types of construction no matter how catchy or how cheap, are built only to attract the pocketbook and are of little benefit to the country as a whole.

I can recall when the electric light was more or less of a novelty, and how my father spoke of the beauties of the electrical display in 1893 at the Chicago World's Fair. I remember when the motion picture was a curiosity in our city; but let me also say that the younger members of my family, less than five years of age, are today taking the radio for granted, turning it off and on at their pleasure. They have stopped looking in the sky when an airplane goes by. It is a fast changing world we are living in. There is more responsibility upon an appraiser and a Realtor to look into the distant future, to guard well against obsolescence, and to stabilize values. We are living in 1933, and Main Street is different than when the first real estate man hung up his sign in 1600.

The three great fundamentals of economics are food, clothing, and shelter. While it has been our purpose today to discuss only the matter of shelter, there is a similar thought running through all three, and the thought is this: "What does a man want?" In eating, some prefer heavy foods while others wish only light foods. In clothing, some prefer gay colors while others want the more somber hues. To a certain degree this is also true in housing. We sometimes have the idea that all men, if given the same amount of money, would each wish the same quality of house. This is not true. Some of the richest men have always lived in humble style, while some with less financial ability have made the most lavish display. In the matter of food, the world through education has become well-informed. Today the wise man eats combinations which he believes to be healthy. As to his clothes, he follows the fashion more or less with economy. Much of the individual design so prominent in the late 90's is now missing, and the individual saves financially by complying with certain fixed rules of good taste, and instead of having many changes of clothing, can find selections of those having the greatest adaptability to many occasions, and so there is less obsolescence and more wear per dollar invested.

But this is only partly true of real estate, in which man invests such a large percentage of his savings. Depreciation and obsolescence in real estate are greatly out of proportion to the funds invested. Different ages of man have demanded different styles of housing. We now find a demand throughout our suburbs for small houses with moderate sized grounds, where a few years ago people wanted large houses. The servant question has been an important factor in the change. But even more so has been the fact that women who formerly devoted their entire day to the management of large houses have now taken other interests in which their thoughts center, such

as civic betterment, welfare, music, clubs, and art, and many have gone into commercial businesses and the centering of their attention upon the lavish show places of the past seems over.

This, together with the financial depression has put on the market from Maine to California many valuable properties which today can be purchased for probably the cost of the shrubbery plus the iron fence which surrounds them. Any appraiser who would attempt to value these properties on the basis of replacement cost would be greatly in error as there is no demand for their replacement, whatever the cost, and in some cases the grounds have been so landscaped that even the ground has no value. The best we can say for them is that they were the pride of a deceased generation, and in their present form have long since outlived their usefulness. They are marvelous examples of complete obsolesence.

Our Mobile Population

If we were to consider for a few moments the matter of the two-story house we would find that this can become obsolete faster than the average person of a generation ago would imagine. All that is necessary today is for some other builder to build a house with a few inexpensive showy attractions or at a lower cost anywhere within traveling distance, and down go your values. Some years ago, one of our moving companies used as its slogan "Keep Moving." Now this might readily apply to the American people of this generation. A generation or so ago they prided themselves that they resided in the same house in which their great grandfather had been born, but today people speak with pride that they have been occupants of every new apartment house which has ever been built. And so we can see that the two-story house and the apartment house and the flat in our large cities are entirely at the mercy of our "Moving Public," who take no pride in possession but only in being occupants of the latest fashion.

A home may be structurally new; the gloss still on the woodwork, the sheen on the paint, and yet be obsolescent. For though it may never have had a tenant in the weeks or months since it was completed, if adjoining it there is a better equipped house with larger garage, more baths, a folding breakfast nook, radio outlet in every room, electric refrigerator compartment, oil or gas heater, or even air conditioner, it has lost much value through competition.

There is another thought of obsolescence which I would leave with you. A few years ago, real estate men were asked by prospective purchasers, the location of churches, schools and public libraries. Today there are new elements such as public garages, drug stores, ice cream stores, moving picture houses, golf courses, which I believe most people will admit are fundamental in the plan of a modern community and which tend one way or another strongly to influence real estate values. I would not say that the American people are not as much interested in their churches, schools, and public libraries as they were in former times, but should the moving picture house happen to be in the neighborhood, it makes that property just that much more desirable.

City Planning

This leads us to the thought of better city planning to reduce obsolescence. The neighborhood community has become an important factor in all large cities and appears to be here to stay. We are told that J. Pierpont Morgan once said: "Any one with good sense must be a Bull on the future of America." This is as true today as it was years ago. We have

had a terrible setback, but remember that the first indication of renewed prosperity has always been a quickening of real estate activity, and the same will probably be true in the present case. Practically no building has been going on for several years. As soon as money is available for industry, and unemployment can be corrected, the small margin of vacant properties now existing should be quickly absorbed. But until there is a decided demand for houses, builders would do well to devote their activities to renovating and improving properties which are already built, many of which today are occupied but at unprofitable rentals. There are other properties in our cities which are untenantable but occupy good space and pay taxes. It is a striking feature that oversupply of houses seldom exists in small communities, and this can easily be explained by the fact that houses in such communities are usually built on the order of the prospective occupant. In other words the demand precedes the supply. In our large cities, thousands of houses, apartment houses, and flats are constructed whenever money is available with no definite occupants in sight, and the builders trust to luck that they will be fortunate in securing enough tenants from other properties to make their new venture successful.

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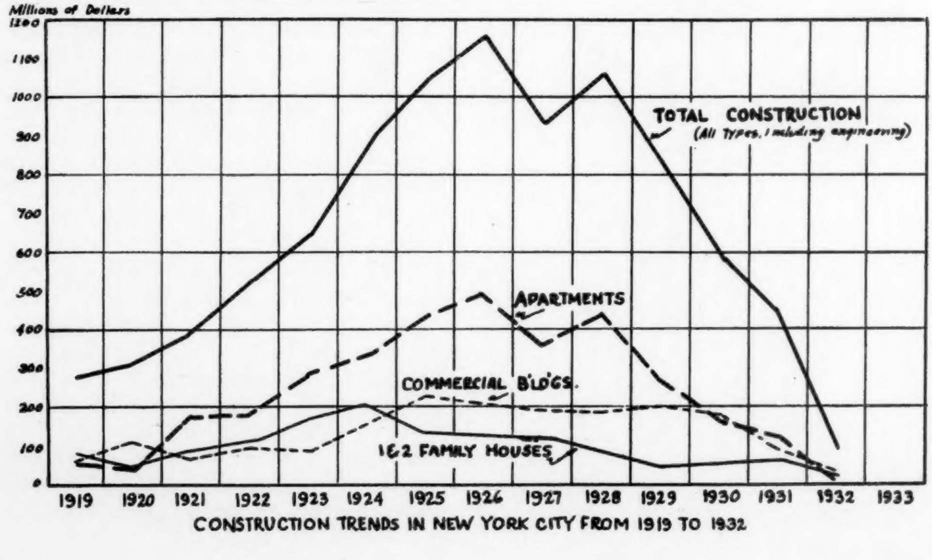
Gitterman—On Land Values

Mr. A. N. Gitterman of New York City, submits the following chart of construction trends in New York City, taken from the "Real Estate Record and Builders Guide," Vol. 131, No. 3 (3364) dated January 21, 1932, and comments as follows: "The chart showing decline from 1,180 millions of construction in 1928 to 110 millions of construction in 1932, proves conclusively that land values, which in the final analysis depend upon demand for building activity, have declined coincidentally."



CONSTRUCTION TRENDS IN NEW YORK CITY FROM 1919 TO 1932

Appraisal of a Business Property

By Max Tieger, M.A.I.

Letter of Transmissal

January 25, 1933

Philip W. Kniskern, President,
American Institute of Real Estate Appraisers,
New York, N. Y.

My dear Mr. Kniskern:

Pursuant to your request, I submit herewith Appraisal Report of a Business Property, for demonstration use.

The subject property is a modern three story and basement structure at the center of the retail business area of Elizabeth, N. J., containing four stores and nine offices.

The site is an irregular plot of land and is, in my opinion, improved to its highest and best use for the remaining economic life of the building, which is 32 years.

The schedule of estimated income and expense is not based on actual rents as reserved in present leases, but is a table of stabilized, or justifiable rental income and expenses.

I have used the Depreciation-Capitalization method in determining the value of this property, and checked the results by the Summation method, resulting in a variation of less than one per cent.

Yours very truly,

M. A. I., Appraiser.

Certificate

I, the undersigned appraiser, do hereby certify that I have personally examined the property hereinafter described for the purpose of making an appraisal thereof for demonstration purposes only.

The schedule of rental income used in determining the value is not actual, but is arbitrarily set up as a justifiable or stabilized rental income.

It is my opinion that this property, classified as an investment property, has a market value at this date of

Three hundred Nineteen Thousand Six Hundred Sixty Nine Dollars and Ninety-Three Cents ($319,669.93).

I have no present interest or contemplated further interest in this property.

This appraisal has been made in conformity with the Standards of Practice of the National Association of Real Estate Boards.

M. A. I., Appraiser.

December 1, 1932.

Location

The property is located on the North-East corner of Broad and East Jersey Streets, and consists of an irregular plot, fronting

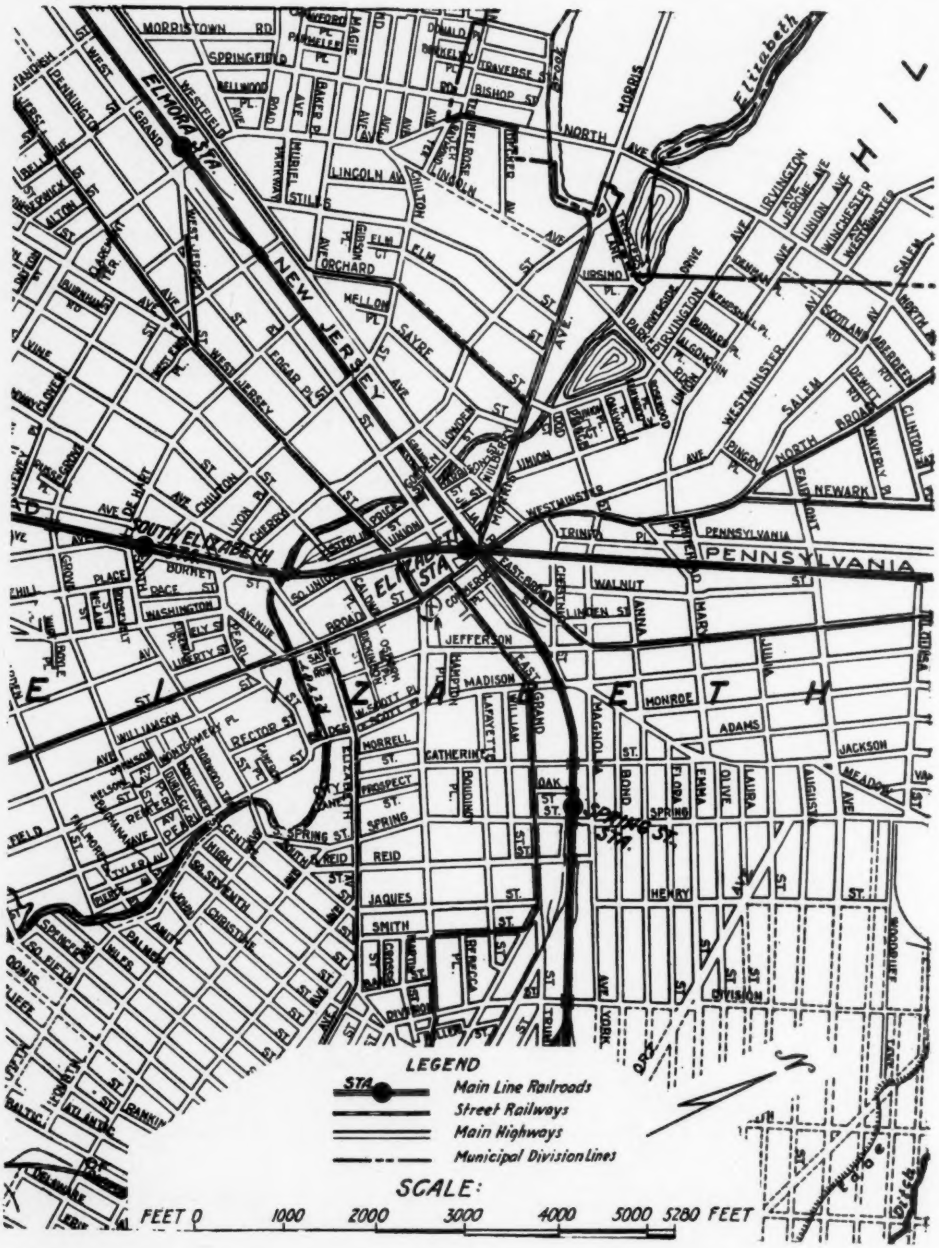
50.62 ft. on the Easterly side of Broad St.

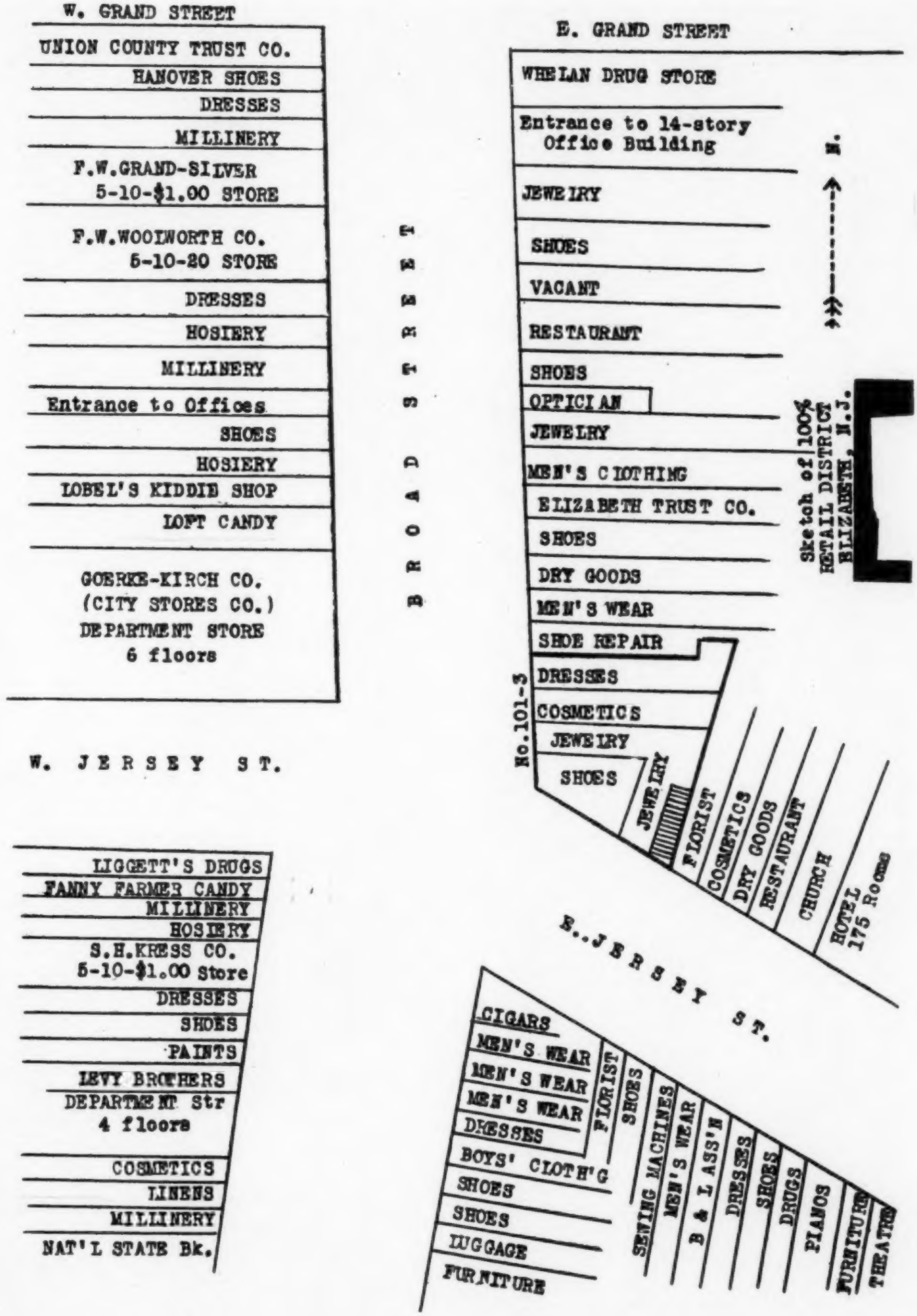
44.58 ft. on the Northerly side of E. Jersey St.

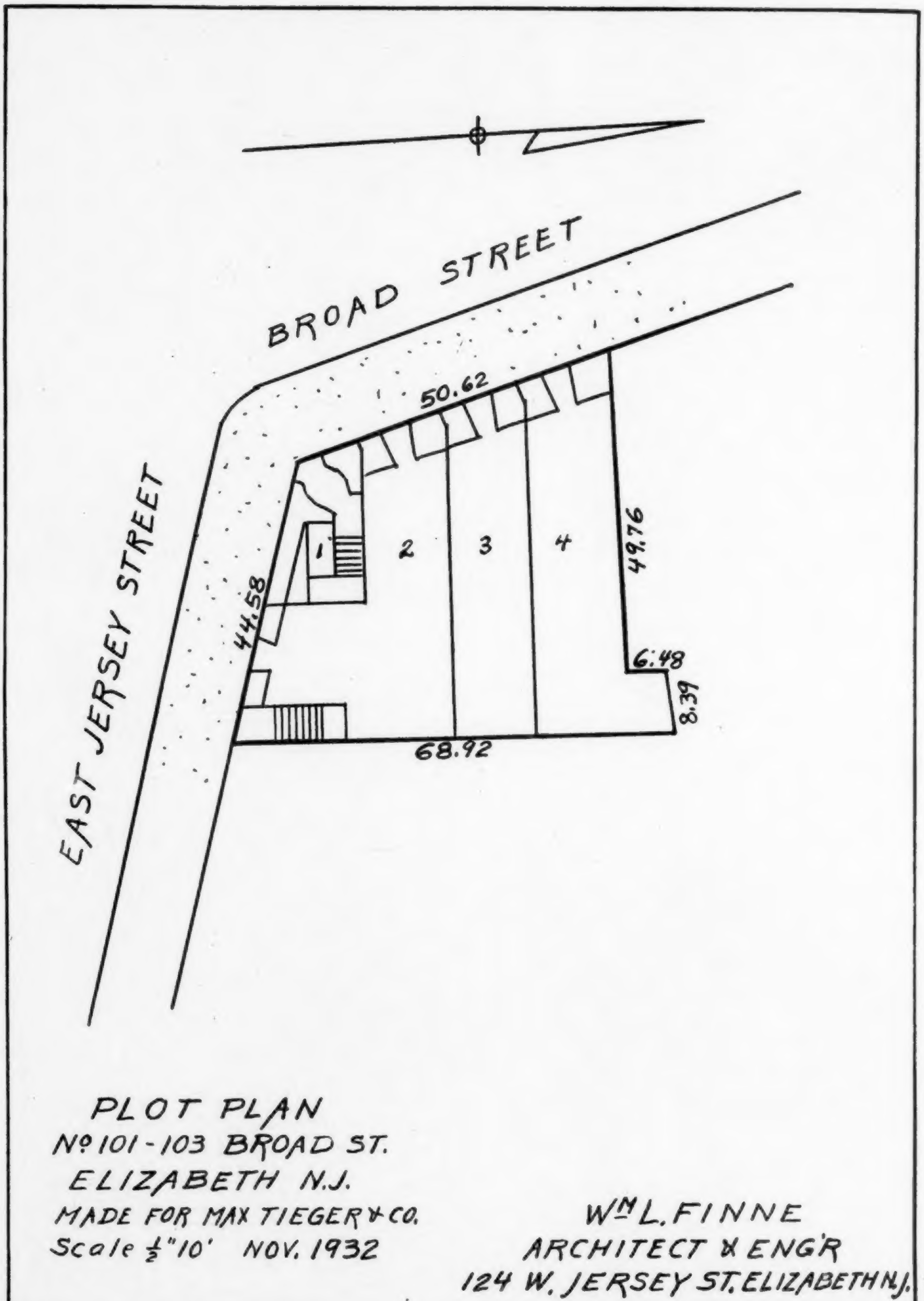
It is known as 101-103 Broad St. and is one of the prominent corners of

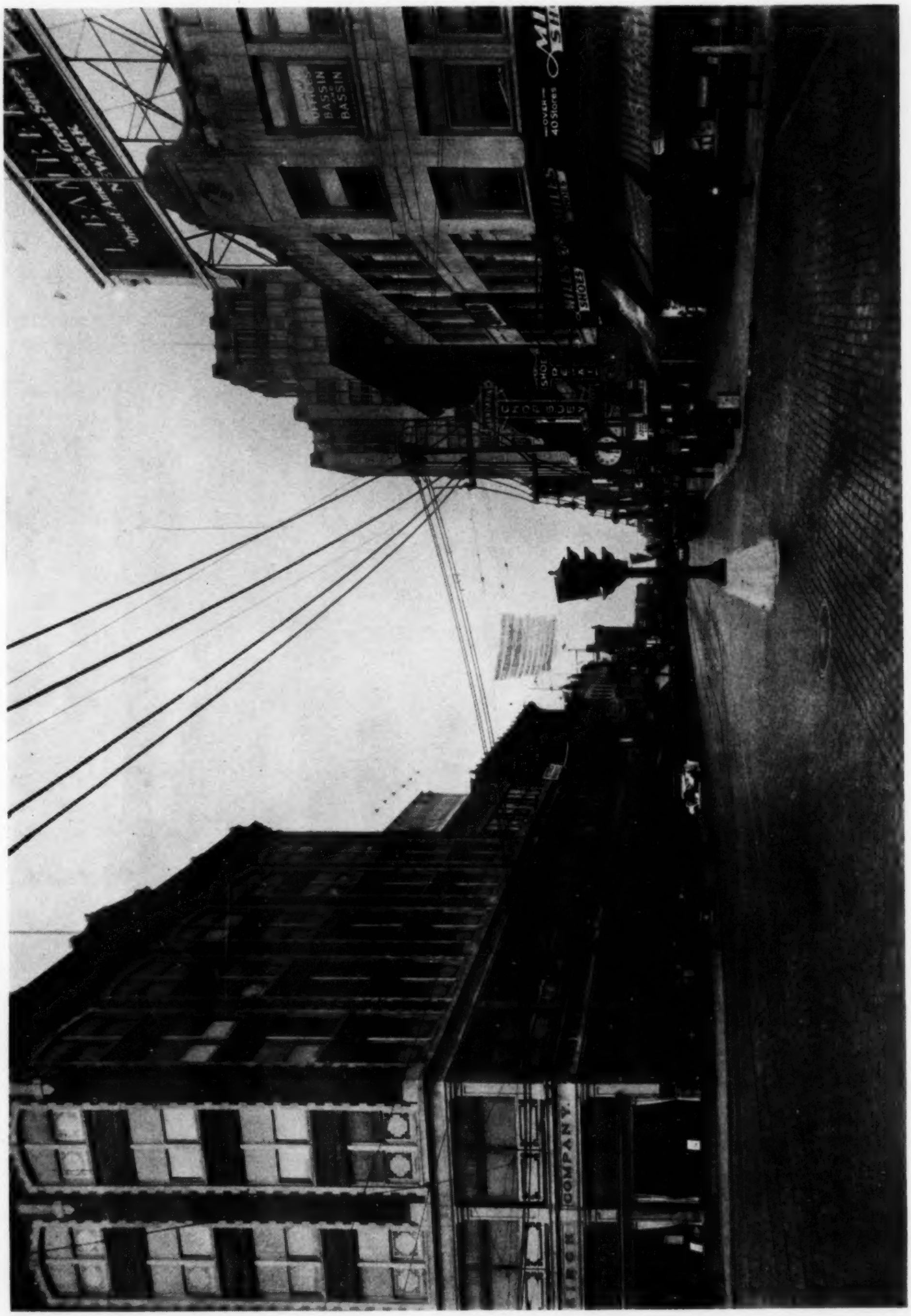
(Continued on page 232)

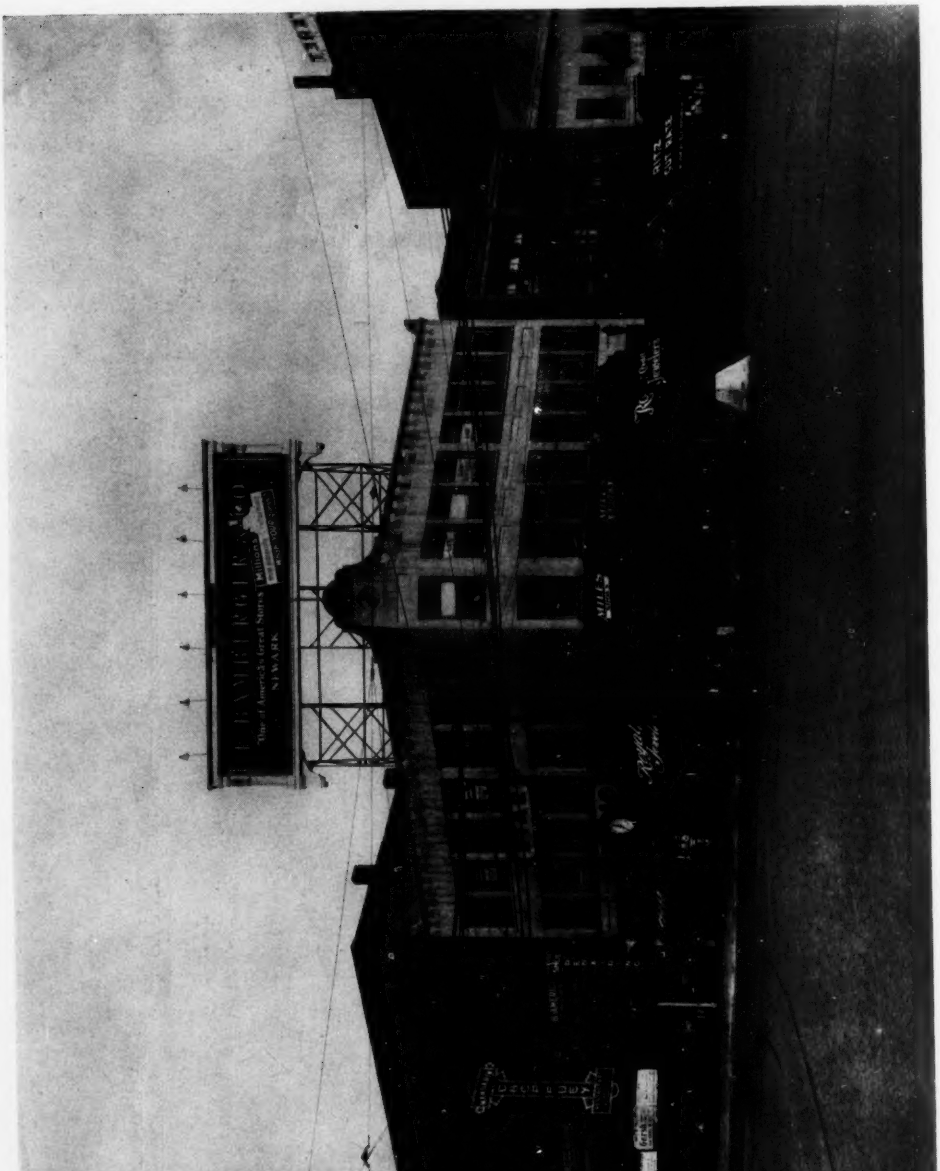
This appraisal and the discussion following it were presented at a session of the Institute in Washington, D. C., January 25, 1933.—Ed.

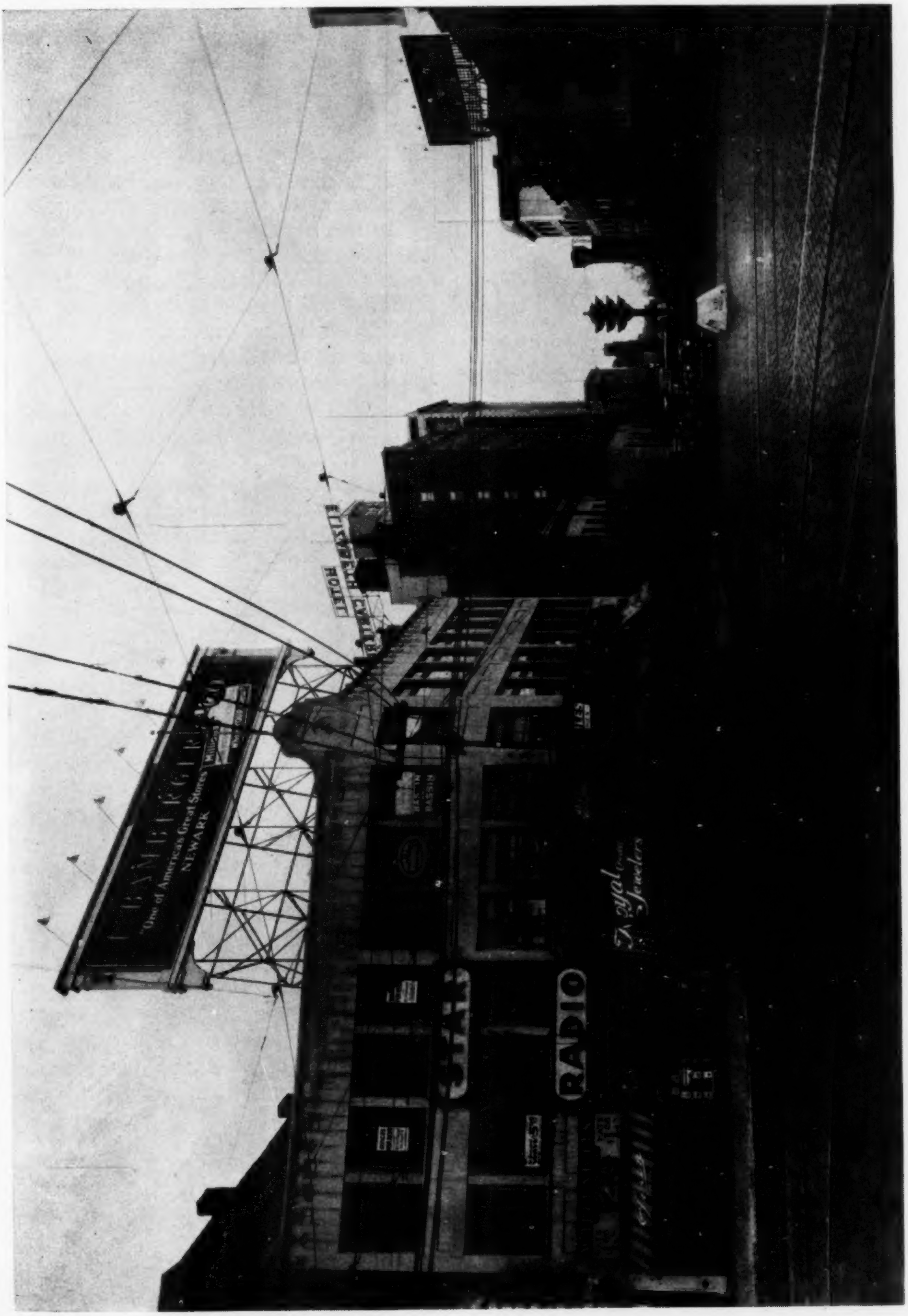

E L I Z A B E T H
H I L
ELMORA STA.
SOUTH ELIZABETH STA.
ELIZABETH STA.
SPRING ST. STA.
NEW JERSEY
PENNSYLVANIA
Elizabeth
LEGEND
STA.
Main Line Railroads
Street Railways
Main Highways
Municipal Division Lines
SCALE:
FEET 0 1000 2000 3000 4000 5000 5280 FEET


W. GRAND STREET
UNION COUNTY TRUST CO.
HANOVER SHOES
DRESSES
MILLINERY
F.W.GRAND-SILVER 5-10-$1.00 STORE
F.W.WOOLWORTH CO. 5-10-20 STORE
DRESSES
HOSIERY
MILLINERY
Entrance to Offices
SHOES
HOSIERY
LOBEL'S KIDDIE SHOP
LOFT CANDY
GOERKE-KIRCH CO. (CITY STORES CO.) DEPARTMENT STORE 6 floors
W. JERSEY ST.
LIGGETT'S DRUGS
FANNY FARMER CANDY
MILLINERY
HOSIERY
S.H.KRESS CO. 5-10-$1.00 Store
DRESSES
SHOES
PAINTS
LEVY BROTHERS DEPARTMENT Str 4 floors
COSMETICS
LINENS
MILLINERY
NAT'L STATE Bk.
BROAD STREET
E. GRAND STREET
WHELAN DRUG STORE
Entrance to 14-story Office Building
JEWELRY
SHOES
VACANT
RESTAURANT
SHOES
OPTICIAN
JEWELRY
MEN'S CLOTHING
ELIZABETH TRUST CO.
SHOES
DRY GOODS
MEN'S WEAR
SHOE REPAIR
DRESSES
COSMETICS
JEWELRY
SHOES
No.101-3
JEWELRY
FLORIST
COSMETICS
DRY GOODS
RESTAURANT
CHURCH
HOTEL 175 Rooms
N.
Sketch of 100% RETAIL DISTRICT ELIZABETH, N.J.
E. JERSEY ST.
CIGARS
MEN'S WEAR
MEN'S WEAR
MEN'S WEAR
DRESSES
BOYS' CLOTH'G
SHOES
SHOES
LUGGAGE
FURNITURE
FLORIST
SHOES
SEWING MACHINES
MEN'S WEAR
B & L ASS'N
DRESSES
SHOES
DRUGS
PIANOS
FURNITURE
THEATRE


BROAD STREET
EAST JERSEY STREET
50.62
1
2
3
4
49.76
44.58
6.48
8.39
68.92
PLOT PLAN
No 101-103 BROAD ST.
ELIZABETH N.J.
MADE FOR MAX TIEGER & CO.
Scale ½" 10' NOV. 1932
Wm L. FINNE
ARCHITECT & ENG'R
124 W. JERSEY ST. ELIZABETH N.J.


BASSIN
BASSIN
OVER 40 Stores
SHOES
COMPANY.


L. BAMBERGER & CO.
One of America's Great Stores
NEWARK


"One of America's Great Stores"
NEWARK
RADIO

the principal intersection of the 100% shopping district.

Directly opposite is the 5-story and basement department store of Goerke-Kirch Co. one of the City Stores units. On the corner diagonally opposite is Liggett Drug Store.

Within a radius of 500 ft. are located

5 of the principal office buildings

2 department stores — (total annual gross sales over $3,000,000; spending $100,000 for advertising)

3 Variety Stores (Woolworth, S. H. Kress, F. W. Grand)

4 Commercial Banks
Elizabeth-Carteret Hotel — 8 stories, 175 rooms

Ritz Theatre (Warner Bros. — 2600 seats)

Water and Gas offices

Leading Specialty Shops

Sixty busses stop per hour directly in front of this property to load and unload passengers, comprising 11 different bus routes. Intra-State trolleys pass by at 15 minute intervals.

Although Broad Street at this point is the center of the retail business area of Elizabeth, East Jersey St. experienced a substantial building boom several years ago which transformed it from a nondescript block of obsolete frame dwellings to a block containing 25 modern retail shops, a hotel, bank, theatre, etc.

In the opinion of the appraiser, this property will increase in value with the growth of the population of Elizabeth's trading area, which has been at the rate of 2% annually for the past 20 years.

Legal Description

A certain parcel of land, with building thereon, located in the City of Elizabeth, County of Union, State of New Jersey, described as follows:

BEGINNING at a point in the Easterly line of Broad St. in a line with the face of the brick of the North Wall of the old Tavern House at the southwest corner of land of the estate of James H. Corry the said point being distant also North 50.62 feet from intersection of the Easterly line of Broad Street with the Northerly line of E. Jersey St. and from said beginning point; thence running along the easterly line of Broad St. (S.7°5′E.) 50.62 feet to northerly line of East Jersey St.; thence running along the northerly line of E. Jersey Street, (S.63°39′E.) 44.58 feet to the face of a brick wall at the east side of the said old brick Tavern House and the westerly line of an alley now open 3 feet in width between east wall of said Tavern House and westerly wall of the brick building on the property of Dr. Charles Davis now in possession of Louis F. Hersh & Bros.; thence running along the westerly line of said 3 feet wide alley and binding from the first 50 feet on the face of east brick wall of said old Tavern House (N.10°21′E.) 68.92 feet to a point and corner of land of Estate of James H. Corry; thence running along the line of land of said Estate of James H. Corry and binding on the face of a brick building on the Estate of James H. Corry and also on the face of a small brick building situated on premises herein described (S.87° 41′W.) 8.39 feet to a point and another corner of land of said Estate of James H. Corry; thence running still along the line of land of Estate of James H. Corry and binding on the face of the brick building situated thereon and also binding on the face of the small brick building situated on premises herein described (S.10°-54′ W) 6.40 ft. to face of the north brick wall on the said old Tavern House and thence running still along the line

of land of Estate of James H. Corry and along the north wall of said old Tavern House (N.79°-44′W.) 49.76 ft. to the place of BEGINNING.

Containing 2,500 square feet.

This property is in Business "A" district, as classified by the Zoning Ordinance of Elizabeth, N. J. and is in full conformity with the provisions of the Zoning Ordinance.

Description of Building

The improvement, covering the entire plot, is a building of three stories and basement (over-all height 48′), erected in 1929, of steel framework, covered with hollow tile and brick. Its Broad St. and E. Jersey St. exterior surfaces are faced with Indiana Limestone. The basement, extending to the street curb lines under both sidewalks, is 10′ high and the major portion of it is used as a retail shoe store. The grade floor consist of 4 retail shops, one of which is "L" shaped, fronting on both streets.

The second floor contains 4 office suites with entrance on E. Jersey St. The stairway is of steel construction covered with marble risers and treads, and marble wainscoting.

The third floor contains 5 office suites. Stairway is of wood construction.

The area of each floor is 2500 sq. ft. plus 760 sq. ft. additional in basement.

The building contains 128,360 cubic feet.

It is heated by steam, generated by a Hardinge oil burner.

Definition of Value

Article 3, Standards of Practice, defines "value" as follows:

> The market value of a property at a designated date is that competitively established price which at that date represents the present worth of all the rights to future benefits arising from ownership.

Valuation of Improvement

To reproduce this building new, today, it would cost $41,075.20, or 32c

Present Occupancy Schedule

Grade Floor:	Type of Occupancy		Justifiable* Annual Rent
Store No. 1 Corner	Shoes		$7,200
Store No. 2 L-shape	Credit Jewelry		7,500
Store No. 3	Cut-Rate Cosmetics		4,500
Store No. 4	Ready-to-wear		4,000
Second Floor:			
Office No. 1 Corner	Law Offices	(680 sq. ft. @ $2.00)	1,360
Office No. 2	Dentist	(480 sq. ft. @ 1.75)	840
Office No. 3	Radio Shop	(520 sq. ft. @ 1.50)	780
Office No. 4	Beauty Shop	(560 sq. ft. @ 1.50)	840
Third Floor:			
Office No. 1 Corner	Law Offices	(400 sq. ft. @ $1.50)	600
Office No. 2	Insurance	(360 sq. ft. @ 1.00)	360
Office No. 3	Vacant	(480 sq. ft. @ 1.00)	480
Office No. 4	Vacant	(480 sq. ft. @ 1.00)	480
Office No. 5	Law Offices	(432 sq. ft. @ 1.25)	540
Advertising Sign Board on Roof			300

*See Kniskern — **Real Estate Appraisal and Valuation:** "The rental value assigned to any space must be such that it will with certainty, permit the profitable continuance of such business as may be suited to the location and building."—Author.

per cu. ft. Its economic life would be 35 years. Since this building is three years old and in good condition it is reasonable to estimate its remaining economic life at 32 years. Its present value is computed as follows:

128,360 cu. ft. @ 32c	$41,075.20
Depreciation, 3 yr. 2 mos. —9%	3,696.77
Present-day value	$37,378.43

Estimated Gross Annual Expenses

FIXED CHARGES:

Taxes: (Land assessed $148,500) Rate: 3.49 (bldg. assessed 40,000)	$6,578.65
Insurance: Fire 40M @ $.52 per $100	208.00
Public Liability	35.00
Workmen's Compensation	20.00
Rent Ins. ($30,000 @ $.52 per $100)	156.00
	$6,997.65

OPERATING:

Water (Estimated)	$120.00	
Repairs	250.00	
Fuel (1000 gals. @ 6c)	600.00	
Janitor	520.00	
Electricity (Estimated)	60.00	
Management (2½%)	750.00	
		2,300.00
		$9,297.65

Valuation by Depreciation-Capitalization Method

From the Estimated Income and Expense Account (page —) we determine the average gross income, for a period of 32 years to be....$30,452.00

Average annual expenses	$10,113.00	
Return on building at 8%	2,990.27	
Depreciation: Sinking Fund factor at 6% for 32 years, 1.1002 per $100	411.24	
		13,514.51
Net Income, Imputable to Land		$16,937.49

This amount ($16,937.49), capitalized at 6% shows the value of land to be..$282,291.50

Summary

Capitalized Land Value	$282,291.50
Depreciated-Reproduction Building Value	37,378.43
Present Value of Property	$319,669.93

Valuation by Summation Method

LAND

Unit Foot Value	$ 5,000.00
(This is an arbitrary figure, justified by values of comparable properties as developed by capitalization of rental income)	$ 5,000.00
Front Foot value ($5000 x .7325-Depth Factor)	3,662.00
54 ft. (average width) x $3662	$197,748.00
Plus extension 6.48 ft. x 8.39 ft. treated as a rear lot	1,859.00
	$199,607.00
Plus corner influence (40%)*	79,843.00

(Continued on page 236)

*The corner influence increment of 40% is a conservative figure, easily justified by the following facts:
1. Ratio of E. Jersey St. to Broad St. is 2 to 5.
2. Especially usable shape of plot; stairway in present lay-out permits use of 4 stores on Broad St. frontage.

(Continued on page 236)

Estimated Income and Expense Account

Future Earnings	1st year	2nd year	3rd year	4th year	5th year	6th year	7th year	8th year	9th year	10-32 years
Store No. 1 Corner	7,200	7,200	7,200	7,500	7,500	7,500	7,800	7,800	7,800	8,100
Store No. 2 L.	7,500	7,500	7,500	7,800	7,800	7,800	8,100	8,100	8,100	8,400
Store No. 3	4,500	4,500	4,500	4,800	4,800	4,800	5,100	5,100	5,100	5,400
Store No. 4	4,000	4,000	4,000	4,300	4,300	4,300	4,600	4,600	4,600	4,900
Total stores	23,200	23,200	23,200	24,400	24,400	24,400	25,600	25,600	25,600	26,800
Less 5% vacancy	1,160	1,160	1,160	1,220	1,220	1,220	1,280	1,280	1,280	1,340
Net—stores	22,040	22,040	22,040	23,180	23,180	23,180	24,320	24,320	24,320	25,460
2nd floor	3,820	3,820	3,820	3,820	3,820	3,820	3,820	3,820	3,820	3,820
Less 10% vacancy	382	382	382	382	382	382	382	382	382	382
Net—2nd floor	3,438	3,438	3,438	3,438	3,438	3,438	3,438	3,438	3,438	3,438
3rd floor	2,460	2,460	2,460	2,460	2,460	2,460	2,460	2,460	2,460	2,460
Less 25% vacancy	615	615	615	615	615	615	615	615	615	615
Net—3rd floor	1,845	1,845	1,845	1,845	1,845	1,845	1,845	1,845	1,845	1,845
Roof Sign	300	300	300	300	300	360	360	360	360	360
Gross Income	27,623	27,623	27,623	28,763	28,763	28,823	29,963	29,963	29,963	31,103
Annual Expense	9,300	9,300	9,300	9,800	9,800	9,800	9,800	9,800	9,800	10,300
Net earnings before capital charges	18,323	18,323	18,323	18,963	18,963	19,023	20,163	20,163	20,163	20,803
Annual charge* for Improvements	3,401	3,401	3,401	3,401	3,401	3,401	3,401	3,401	3,401	3,401
Net Income Imputable to Land	14,922	14,922	14,922	15,562	15,562	15,622	16,762	16,762	16,762	17,402

*8% on building value, plus sinking fund sum based on 32 years at 6%.

Total Land Value..........	$279,550.00
Building Value	37,378.43
	$316,928.43

Comparison

Value by Depreciation-Capitalization Method..	$319,669.93
Value by Summation Method	316,928.43
Variation in methods (8/10s of 1%) ....$	2,741.50

Supporting Data

Comparable Land and Rental Values

Since there have been no sales in over 8 years, of comparable property, the land value hereinbefore determined by the Income Method should be checked, or compared, with resultant land values of comparable leased space, capitalizing net income to determine land value:

129 Broad Street—Whelan Drug Co.

Percentage lease (9% on gross sales) year ending Sept. 1932. Store 30.5′ x 64′ (1952 sq. ft.) Annual Rent	$14,000.00
Analysis, to determine land value:	
Bldg. (hypothetical) cost: 43,000 cu. ft. @ 32c......	13,750.00
	$14,000.00

Income:		
Expense: Int. on Bldg. @ 6%......	$1100.00	
Sinking Fund Payment	90.00	
Tax (Est. Bldg. 10M-Land 75M)	3000.00	
Insurance (12M @ $10.)	120.00	
Heat (Est.)	250.00	
Vacancies and Repairs (5%) ..	700.00	
		5,260.00
Net rent imputable to land..$		8,740.00

Dividing $8740 by 6% results in a land value of $145,666. Dividing $145,666 by 30.5′results in a front ft. value of $4,775.

Dividing $4775 by 82% (depth factor for 64′) results in a unit foot value including corner benefit of $5823.

Deducting 25% (which is a fair corner influence for East Grand St.) results in a unit foot value of $4367.

Similar analyses of other recent leases in the adjacent properties show the following results:

127 Broad St.—Howard Jewelry Co.

Rent, adjusted September 1932, $4,380.00. Store 15′ x 45′ (average depth). Rent per sq. ft. $6.50. Capitalized land value, unit foot $4280.

109 Broad Street—Gershberg's Dry Goods Store

Leased Sept. 1932 — Annual rent $3600. Store 10′ x 60′. Rent per square foot $6.00. Capitalized land value, Unit foot $4220.

115 Broad Street—World Clothing Exchange

Leased May 1932. Annual Rent,

(Continued from page 234)

3. Substantially increased rental value to offices on upper floors due to added light, air, and visibility.
4. Under present arrangement, basement is utilized for selling space so that corner store is used entirely for displaying of goods.
5. "Removal" of corner benefit by constructing a hypothetical wall (say 8" thick) alongside of East Jersey St. surface of building, shutting off light, air, accessibility and visibility would result in reduction of net income of at least $4800 which, capitalized at 6%, represents $80,000 depreciation in value.

The following is a comparison of corner influence methods as applied to this property:

1. Zangerle's method results in corner influence of	$65,280.00
2. Stafford's method results in corner influence of	71,858.52
3. Lindsey-Bernard's method results in corner influence of	77,010.00
4. Present Appraiser's method results in corner influence of	79,843.00
5. Thorson's method results in corner influence of	89,823.15

—Author.

$8400. Store 22′ x 100′—Rent per square foot $3.50. Capitalized land value, unit foot $3270.

Note: In this instance, a greater rent return would probably be obtained by dividing the store into two smaller units; present income indicates property not improved to highest and best use.

125 Broad St.—Walkover Shoe Co.

Rent, adjusted September 1932, $5700. Store 15′ x 90′. Rent per square foot $4.00. Capitalized land value, unit foot $3700.

1163-5 East Jersey Street—Bargain House

Leased May 1932. Annual rent $4200.00. Store 20 x 100. Rent per square foot $2.10. Capitalized land value, unit foot $1990.

1151 E. Jersey Street—Benull's Ladies' Apparel Shop

Leased September 1932. Annual rent $2400. Store 25′ x 40′ in Elizabeth Carteret Hotel. Rent per square foot $2.40.

1147-9 East Jersey Street—Stafford Building, 5 Stores

Stores 12′ x 75′. Annual rent, each store, $1800. Rent per square foot, $2.00.

—

Comparison of Rent Store No. 1 with store located 97 Broad Street, leased November 15, 1932;

No. 97 Broad Street is an irregular corner store, across East Jersey Street from Store No. 1. Area 414 sq. ft. Yearly rent, $3500; $8.45 per square foot.

Store No. 1 includes 3000 sq. ft. in basement (retail selling space) valued at $4500 ($1.50 per foot) leaving as residual rent to corner store, $2700 for the 312 sq. ft. of space on ground floor; $8.65 per sq. ft.

Facts About Elizabeth, N. J.

Elizabeth has a resident population of 115,000 and a trading population of about 250,000. It is the county-seat of Union County.

Assessed value of real estate: $166,-699,705.00.

Federal Census Reports:

1910	73,409
1920	95,783
1930	114,545

(avg. annual increase: 2%)

Tax Ratable Increase:

1910	$ 54,408,430.00
1920	87,832,544.00
1930	166,011,057.00

Industries: 238 Diversified Industries. $116,166,000 Annual Production Value. $31,365,000 Annual Payroll. 17,039 Male Employees. 3,864 Female employees.

Finance: 6 Commercial Banks: Deposits $42,273,000.00; 3 Savings Banks, Deposits $36,370,000.00. 45 Building & Loan Associations: 32,000 Members—$30,000,000 Assets.

Theatres: Seating capacity of theatres and motion picture houses: 15,-600.

Newspapers: Paid circulation of local press: 38,000.

Hotels: 2 modern, 300 rooms.

School Attendance:

Elementary	10,603
Junior High	5,075
Senior High	2,754
Vocational and continuation	607
Total attendance	19,039

❖ ❖ ❖

Comments and Discussions

Reeves — **On The Capitalization Rate Used In Max Tieger's Appraisal**

SO MUCH depends upon the rate at which net earnings are capitalized that it is especially unfortunate to have no definite standard for adoption by the practitioner. Our courts have, in general, evaded the issue by giving negative decisions; for instance, in the Kansas City Stock Yards case it was held that a State statute limiting the net return to 5.3% was not confiscatory, although it reduced the previous net income nearly 50%.

On the other hand, many regulatory bodies, such as Public Service Commissions, hold that 7% or 8% is a fair return upon capital invested in what we have in the past fondly believed to be non-hazardous enterprises—public utility properties operating in monopolistic fields.

Upon retrospection, it seems that, without definite or demonstrably justifiable reasons, I have used rates varying from 6% for land in an apparently assured central business district, to 10% for water rights assembled and used in a hydro-electric plant. One might think that the latter occupies a preferred position entitling it to a lower rate. Within the past decade, however, we have seen hydro power lose its economic preeminence due to greatly lowered costs of coal and to radical improvements in steam plant design. This, of course, applies especially to water powers with unstable flow, and to those remote from their field of service.

My point is that this is an iconoclastic age; all our gods are being dethroned; man's invention and craftsmanship makes the permanent turn out to be impermanent.

I call your attention to the able and interesting discussion entitled "Establishing the Capitalization Rate," by Mark Levy, in our October, 1932, "Journal." Among the factors to be considered, he cites the success of management required for investments in real estate over those of a more intangible character, and the questionable negotiability of capital so invested. Mr. Levy comments upon the practice of applying one rate in capitalizing land and another for its structural improvements, and calls attention also to the common acceptance of net return as being the equivalent of an annuity in perpetuity.

Let us now see how the foregoing applies to the case in point—Mr. Tieger's appraisal of the commercial property at Broad and East Jersey streets, Elizabeth, New Jersey.

First, while admitting that I cannot disprove his selection of 6% as the rate at which to capitalize the estimated net return, I fear that *he* cannot prove it, *indisputably*; so small and reasonable an increase as 1% reduces the capitalized land value from $282,291 to $242,000, and the use of what some of us might think to be appropriate, say 8%, would make the value only $211,800. It is not within my province now to indicate the disastrous changes consequent upon substitutions in such other hypotheses as income and expenses.

Although the building is a small unit of only three stories in height and with but 2,500 sq. ft. of ground area, there are four ground floor stores and many more tenants upstairs, so that the property has the disability of management cost suggested by Mr. Levy's treatise. True, Mr. Tieger cites its location at the most desirable intersection in a city of stable growth, but we have probably passed the zenith of urban centraliz-

ation, and land value increment may not again develop so rapidly as in the past. Apropos of that, by reference to the population figures cited, it will be found that while the average rate of increase from 1910 to 1930 was 2¼%, the first decade showed an increase of 2⅝%, which slowed down to 1⅞% annually from 1920 to 1930.

Mr. Tieger capitalizes at 6% to determine land value, but uses 8% as the rate of return to be demanded upon the depreciated building value. Applying this principle in the ensuing years to a constantly diminishing building value, the income allocated to building investment would be progressively less, and as the structure grew older the land upon which it stood would, *ipso facto,* compute to greater values in those years.

Moreover, inasmuch as amortization of the building is provided for, and all other known expenses, why not use 6% as the rate for building return, as well as on the land? By this substitution, the net income is increased $750 per year, and the land value raised $12,460.

Conversely, if we adopt conservatism; and, knowing that shopping habits change, as do all other things, so that this corner may pass into decadence, assume our net rental to be an annuity for some finite period, say 30 years, the capital value is consequently much lower than as computed in Mr. Tieger's report.

By this time you have all perceived that I hold no brief for the income-capitalization hypothesis of valuation as a panacea for all appraisal ills. To me, it is valuable as a check, especially so as an approximation to test the suitability and adequacy of improvements, actual or proposed.

Cuthbert E. Reeves, M. A. I.
Buffalo, N. Y., January, 1933.

Schmutz and *McCormick* — On The Capitalization Rate Used in Max Tieger's Appraisal

AFTER perusing the Max Tieger report for the purpose of commenting upon the Capitalization Rates used therein, we have formed the opinion that the property has been over-valued, for the following reasons:

1st: Because of an insufficient amortization fund to provide for the return of capital invested, occasioned by the use of a 6% compound interest rate in the Sinking Fund, which should not have been in excess of 3.5%; and

2nd: Because of the employment of Split-Rates to Land and Building which are too low to attract capital to this type of investment, —

A. In view of the ratio of Land to Building value, which would **normally** require the use of a 7.3% rate for Land, and a 9% rate for the Building, in this case; and

B. In view of existing conditions, environing all investment properties and markets, the aforementioned rates should be still higher than those just mentioned.

The following discussion will point out the reasons upon which the above conclusions are based:

Considering the first, that the sinking fund interest rate is too high: There are many appraisers who use high rates of interest; that is, rates in excess of 4%, in setting up an amortization fund. When any rate is used for an amortization fund, it is assumed that the funds invested in the sinking fund will compound at the rate selected. This assumption, that money can be compounded at high interest rates, such as 6%, is utterly erroneous, and is to be condemned.

Over long periods of time, the rate of growth of capital throughout the world is about 3.5% per annum, compounded, and this rate represents the

maximum figure which should be used in any amortization fund providing for the return of invested capital. Both the savings bank rate of interest for the nation, and United States Government obligations, tend to hover around the safe rate of interest, or the actual growth of the country, i. e., at about 3.5% per annum.

Over long periods of time it is the tendency for gold and its effectiveness to increase at the same rate as the natural increase in the wealth of the nation, but sometimes, such as during the past fifteen years, the increase is less, with the ultimate result that commodity prices fall, and interest rates fall as well, and supposed accretions of capital, in sinking funds or otherwise, are diminished or completely dissipated by bank failures, bond defaults, reductions in capital value, or otherwise.

To show the utter fallacy of the use of high interest rates for amortization purposes, let it be assumed that Queen Isabella of Spain had invested $10,000 in a 4% compound interest account, in the year 1492, instead of outfitting Christopher Columbus for his discovery expedition. Calculations show that had she so invested then, at this time (1932) there would have accumulated in this sinking fund the sum of $676,000,000,000 (676 billions of dollars), which is more than the value of the North and South American continents combined.

However, had this money been compounded at 6% per annum, instead of 4%, there would have accumulated $6,339,276,595,000,000 (6 plus quadrillions of dollars) which is more than 8,000 times the capitalized value of the whole world.

In the Tieger Report, had a 3.5% interest rate been used, the charge for depreciation would have been $651.87 rather than $411.24, and hence an undercharge has been made, thus imputing $240.63 to the land in excess of what should have been, because of this matter alone.

Before considering the second criticism, it will be necessary to point out the reasons why split rates, e. g., 6% for land and 8% for building, are dangerous, and why they should never be used unless they have been first calculated, and other relationships thoroughly understood. There is no warrant for the unequivocal use of any definite set of interest rates, such as 6% and 8%, as used in this report, as the following discussion will point out:

Rates of capitalization are largely determined by the degree of risk involved in the use of the funds. Generally speaking, the first 50% of the value of the property can be borrowed on at a 6% rate, and this portion of the value of the property is designated as the Creditor's Position; the second half of the value as the Debtor's Position. Therefore, if the Over-All Rate (to land and building combined) were 7.5%, and the rate applicable to the Creditor's Position were 6%, obviously the rate applicable to the Debtor's Position would be 9%. However, if the Over-All Rate were 7.5%, and the building equaled 75% of the value of the property (i. e., three times the land value), it would be found that the land will carry a 6% rate and the building an 8% rate; or, if the building were 25% of the total value of the property (i. e., one-third of the value of the land), then the land would carry a 7% rate and the building a 9% rate, as shown in the following tabulation:

	Total	Total	Over-All	LAND			BUILDING		
Case	Investment	Income	Rate	Value	Rate	Int.	Value	Rate	Int.
1.	$10,000	$750	7.5%	$2500	6.0%	$150	$7500	8%	$600
2.	10,000	750	7.5%	5000	6.0%	300	5000	9%	450
3.	10,000	750	7.5%	7500	7.0%	525	2500	9%	225

The computations made in arriving at the above figures were as follows:

CASE 1.

Total Net Income..........................year, $750.
Creditor's Position—6%
Land $2500 @ 6%.................................. 150.
Imputable to Building.............................. 600.
Then, $600. divided by $7500 = 8%
OR,
Creditor's Position—6%

Land	2500 @ 6% = 150	
Building	2500 @ 6% = 150	300.
Debtor's Position—9%		
Building	5000 @ 9% = 450	450.
Total Property @ 7.5%		750.

In this case, a portion of the building comes in the first half of the value of the property, and hence takes the Creditor's Rate, 6%; the remainder falls in the Debtor's Position, and hence takes the Debtor's Rate, 9%.

CASE 2.

Total Net Income..........................year, $750.
Creditor's Position—6%
Land $5000 @ 6% = 300
Debtor's Position—9%
Land $2500 @ 9% = 225 525.
Imputable to Building.............................. 225
Then, $225 divided by 2500 = 9%
AND

Land, in Cr. Position—$5000 @ 6% =	300
Land, in Dr. Position—$2500 @ 9% =	225
Total Land—$7500 @ 7% =	$525

Thus is it seen that "split rates" cannot be arbitrarily assigned under all conditions.

The 7.5% Over-All Rate herein assumed usually obtains for property of the type appraised by Mr. Tieger, during a period that is static, both as regards the price level and other environing agencies.

However, if the price level moves up or down, the Over-All Rate will likewise move either down or up. During the past three years the price level has declined 35%, and the Over-All Rate necessary to attract capital to any type of investment has naturally increased.

Considering the Tieger Report, if an Over-All Rate of 7.5% were proper—under static conditions—then the Split Rates for land and building which should have been used by Mr. Tieger, would have been as follows:

7.30% for land and 9% for building, computed as follows:

As shown in report—

Value of land (approx.)	$ 37,500
Value of building (approx.)	282,500
Total value of property	$320,000

The first 50% of the value of the entire property falls in the Creditor's Position, and should therefore take a 6% rate; the second half falls in the Debtor's Position and should take a 9% rate. Then, the Split Rate computations may be shown as follows:

Value of tne Property	$320,000
Over-All Interest Rate	7.5%
Net Income to Land and Building $24,000 year	$24,000
The Net Income to Land should be 6% on $160,000 (50% of Land) =	$ 9,600
9% on $122,500 (balance of Land) =	11,025
Total $282,500 =	20,625

Then, $20,625 divided by 282,500 = 7.3% the rate to Land.

The interest rate to the building would be 9%, as stated.

RECAPITULATION

Land Rent 7.30% on $282,500 =	$20,625
Building Interest 9.00% on $37,500 =	3,375
Total	24,000

The above calculation would prevail only if the Price Level were constant and statically environed. Under any other conditions, the rate would be different, either higher or lower.

If a property is increasing in price, that portion of the value known as the Debtor's Position, or the equity, receives the increment; conversely, during a falling price level, it suffers the loss. Therefore, if properties are rising in price, the risk to the Debtor's Position decreases, and the Over-All Rate lessens; but when properties are falling in price, the risk of the Debtor's Position increases and the Over-All Rate increases.

When the best of preferred stocks and some good bonds are selling to yield 8%, and when first mortgages with substantial equities can be acquired to yield the same interest, which situation exists today, it becomes obvious tnat it would be indeed difficult to sell a piece of realty on a 7.5% basis. Therefore, if it would require an Over-All Rate of more than 7.5% to move the property appraised by Mr. Tieger, and we sincerely believe it would, then the Split Rates of 7.3% to land and 9% to building would be too low.

The proper Over-All Rate to be used can be calculated by considering the disequilibrium existing between the major factors in production, as contrasted with a previous norm. To show how this is done is beyond the scope of this article; and the only attempt here made is to call attention to a few of the simple factors to be considered when selecting capitalization rates, such as would govern in this case.

A famous French thinker once remarked that the greatest failure of mankind was in arriving at a conclusion without first validating the premises from which the conclusion was derived; and that this failure was more pronounced in those having a knowledge of mathematics than in those who had not. That this accusation is warranted is hardly open to dispute.

Failure to validate the assumption contained in any process, coefficient, rule, or formula, may vitiate the conclusion arrived at by the use of such reckoning, irrespective of the fact that correct mathematical procedure may have been followed. *Quod erat demonstradum!*

George L. Schmutz.
Loring O. McCormick.

Los Angeles, January, 1933.

Goldstone — On The Capitalization Rate Used in Max Tieger's Appraisal

IT IS my opinion that no fixed and definite rate of capitalization can be used in all cases. The rate of capitalization will depend upon the type of property and upon local conditions. For example, we know that in our newer and Western cities money is usually hired out at a higher rate of interest than in our older Eastern cities. The interest rate on other forms of investment with which real estate must compete will differ in different parts of the country, and therefore the rate must necessarily vary. Furthermore, the risk and hazard involved in the ownership of certain types of property will increase or decrease the rate of capitalization. For example, an owner of property located at the corner of Wall street and Broadway in the City of New York may, for the year 1933, be satisfied with 5% or even 4% net return because it is relatively safe and sound, and can be collected with a minimum of trouble and expense. An apartment house owner may demand and would naturally be entitled to a higher rate of return. Certainly the owner of an industrial property would not be satisfied with the same rate of interest that an owner of a high-class office building in the 100% location would be content to accept. He would demand a higher rate of return, due to the risks and hazards of ownership. There are other factors which now demand the attention of the appraiser, which have hitherto been too often neglected in the fixing of the various rates of capitalization of income, to-wit: (a) The purchasing power of the dollar; (b) the average yield of high-grade stocks and gilt-edge bonds over a reasonable period of time prior to the date of appraisal and a study of the present interest-yielding experience tables of these securities in order to formulate some opinion as to

expectancy yield of investments coming into direct competition with real estate; and (c) all pertinent economic factors.

Bracton Goldstone, M. A. I.
Washington, D. C., January, 1933.

Kniskern — On The Capitalization Rate Used in Max Tieger's Appraisal

IN DISCUSSING the question of capitalization rate and particularly the use of an 8% rate for the building and a 6% rate for the land, it should be noted, in the first place, that the capitalization rate is a mechanical manner of expressing the relative *quality* of the income from a property.

Income may be in the form of money, use, protection, or appreciation. We determine the gross income, expenses, and vacancies to establish the quantity of income; by the capitalization rate we express the quality of that income, and then turn to the interest tables to reflect the duration of that income.

By his procedure Mr. Tieger has converted all of the brick, mortar, and other physical elements into a net annuity which is a form that is analogous and comparable to bonds, stocks, and other forms of investment. It has been reduced to a definite number of dollars as a net income to be expected and the hazards and benefits to the invested capital as well as the hazards and possibilities of the income have been determined.

In valuing improved real estate by the capitalization of net income, it must be borne in mind that the net income from the property is produced by a combination of land and building. It cannot be said that the land produces any particular or definite part of that income, nor that the building produces any other part. One portion of the income cannot be characterized by some conditions solely of land and those conditions entirely eliminated when determining the character of the other portion of the income. Any net income has only one set of characteristics, elaborate as they may be, and this set of characteristics attaches uniformly to each and every individual dollar of the total net income. These characteristics are created by an existing combination of land and building. Therefore, the entire net income for any one year from a particular interest in real estate must be capitalized at the same rate.

As has been stated, the income method of valuation consists of the translation of the physical combination of land and buildings into a series of net annuities and the determination of the characteristics of those annuities. The final step commonly spoken of as the capitalization of the income, strictly speaking is not, at that point in the work, a valuation of real property at all, but technically it is the valuation of a given set of annuities with certain characteristics.

The valuation of these annuities can give only a total value. Any holding of real property has only a value of the whole, and any division of this whole value between land and building is an arbitrary allocation on the part of the appraiser.

It is, nevertheless, entirely proper for the appraiser in his best judgment to so allocate a part of the value to land and another part to the building in such a way that the total of the allocations equals the whole. This may be accomplished by allocating a part of the net income to land and a part to building, which again is entirely proper. However, quite regardless of the method or care used in allocating income to one or the other part of the property, the characteristics of each dollar of net income remains the same, whether it be allo-

cated to land or to building, and for that reason every dollar of net income, regardless of allocation, must be capitalized at the same rate.

Whenever a building is erected upon a parcel of land the building and the land each lose their identity to the combined whole. The value and earning power of the building as well as the value and earning power of the land are insparably merged into the value and earning power of the combination of land and building. They remain merged so long as the buildings exist and cannot during that time be taken nor treated as separated units.

It does not seem possible that of any two dollars of net income it can be said that one is derived from land and is a 6% income worth an investment of $16.67, while the other dollar from the same property, possibly originating from the same tenant, is said to be derived from the building and worth the investment of only $12.50, or on an 8% basis. Both dollars are derived from a combination of land and building; neither is derived solely from land or solely from building. They are both identical in source and in characteristics and therefore both must be capitalized at the same rate.

It is impossible to separate the various dollars of net income and say that this dollar is received from the land and that dollar is received from the building. It is possible, however, to allocate the various dollars of income to particular purposes. All dollars of the same income must be capitalized at the same rate whether allocated to land or building.

This, however, should not be confused with the rate used for capitalizing the value of the land in reversion, after the exhaustion of the buildings.

Philip W. Kniskern, M. A. I.
New York, N. Y., January, 1933.

Thorson — On The Capitalization Rate Used in Max Tieger's Appraisal

TO PASS intelligently on the proper capitalization rate to be used in any appraisal, it is manifestly necessary to have on hand sufficient data adequately to judge the risk involved. That is, data or statistics on which we may base an opinion as to the stability of the income and the certainty with which we may expect the return of our original investment.

Besides the data given I should require the following to brace my judgment before indicating what in my opinion would be the proper investment risk:

1. Actual rentals for the past three years from this property and rentals from similar properties in Elizabeth for the past five years. We can judge the future only by the past.
2. A list of leases with time to run, if any.
3. Responsibility of the lessees. This becomes important under present conditions, as on the financial solidity of the lessees will depend their ability to carry on to a considerable extent.
4. The actual rentals paid now. An analyst of the appraisal should be given an opportunity to judge how far the "justified" rents are justifiable.
   This is germane because Mr. Tieger quotes as supporting data rents from a drug store paying 9% on its gross sales. I believe 6% is the maximum a drug store can pay for rent.
5. We should have a foot traffic count. Such traffic should furthermore be analyzed as to type and possible buying capacity.
6. A trend chart indicating directional growth of the city and also showing the relative position of this property to the highest rental spot in the city. This chart should also include zoning data so that the extent of possible competition might be judged.
7. An increase in population has been presumed over the 32 years representing the economic life of the improvement. The Pearl-Reed logistic curve worked out for the United States, for 1910 back, has

proven almost 100% accurate for the 1920 and 1930 censuses. From the predictions of this curve increase in population will cease altogether in 2100. However, at the rate of decrease obtaining the last nine years the increase in the population of the United States will cease in from 40 to 60 years.

8. More or less reliable statistics have shown that, roughly speaking, there is a $1.00 per unit foot value created in the hot spot of a city for every 40 inhabitants. While this is a rule of thumb it has for its basis a very tangible thing—number of people. It clicks surprisingly well where we have checked it. Further information would indicate that the highest priced inside land in a city of the size of Elizabeth would be not over $3,000 per unit foot. While this should not be given too much consideration, it contributes to a correct judgment.

9. It is doubtful whether a sinking fund could expect compound interest at a rate of 6% over the 32 year period. I believe 4% would be the maximum. This would make a difference of approximately $184 per year in the amount of the sinking fund. That is, it would be larger by this amount.

Not having all data at hand, and not having access to information which no doubt is available to Mr. Tieger, my judgment would be that the income forecast in this appraisal is too high, or at least very speculative, and therefore if the figures given are used, the income should be capitalized at a fairly high rate,—say 10%. That is, the net income should be capitalized at 10% to reflect the warranted value of the property. It is furthermore the writer's opinion that the income return will have to take care of considerable shrinkage in the property values.

The above conclusion is based on the present high value of the dollar and will of course fluctuate with an inflation of our dollar. If some of the bills now before Congress materialize, which have for their object the reduction of the purchasing power of the dollar to the 1926 basis, this change will be reflected in a higher warranted price of the property. The purchasing power of the dollar, according to government report, is today $1.74 plus in terms of the 1926 dollar.

From the paucity of data on which the above estimate is based, it is evident that it is merely a more or less unsupported opinion.

Ivan A. Thorson.

Los Angeles, January, 1933.

Thompson — On The Prophetic Analysis of Future Benefits in Max Tieger's Appraisal

THE problem suggested by the subject assigned is one which comprehends most uncertain and dangerous elements. All our appraisal work is prophetic analysis. This is the crux of the whole proposition. The onus placed upon us is charged with dynamite. An appraiser is not employed to state obvious facts. Any intelligent layman might do as much. An appraiser is employed as one who by reason of experience, research, technical knowledge, analytical ability, and sound judgment, is capable of reaching conclusions as to present and potential values.

The appraiser must be concerned with unguessed emergencies for good or for ill, that will affect our economic condition in the not too distant future. We may, with fair assurance, say what rent values will be a year hence, or even three years hence, but who can say what they *should* be or what they *will* be ten years hence? Greater respect will be entertained for appraisers who admit being human than for those who pretend infallibility in forecasting general market conditions a decade beyond today. It must be recognized that in our complex civilization there exists artificialities which influence, temporarily at least, the natural laws of economics. For in-

stance, rates of wage established by trade unions; the facile and too often fallacious opinions of tax assessors; city, state, and national budgets; the changing attitude of investment bankers frequently affected by wholly unrelated phenomena of the general market; to say nothing of draughts, floods, epidemics of disease, and finally war, by which our land may be "rent with civil feud or drenched with fraternal blood."

Our desire and our purpose should be to analyze conditions with conservatism consistent with facts. In order to do this, we must stand Janus-like, facing two arenas, the past and the future. We must reason by analogy. We must base our inferences as to the future upon the performances of the past. After determining the fair rental as of the day of appraisal, one must consider to what extent present rentals are affected by business conditions. It is the duty of the appraiser to discount present conditions; to determine whether the general market is normal, sluggish, or inflated, and to correct his estimate accordingly. The onus incumbent upon him is to adjust past conditions and trends with values. Until more complete data is available; until accurate graphs are prepared; until reliable statistics are evolved from past market trends; until we have gone deeper into this side of our science; we should not venture too far with prophecy. Our judgment should be on the side of conservatism.

The temptation is to quote authorities rather than to attempt original ideas in this too limited monograph. Kniskern, both the Babcocks, McMichael, Wenzlick, Thorson, and Mertzke, each have in recent able treatises dealt with the subject of prophetic analysis. To the works of these gentlemen I can only refer rather than discuss them *in particularum*. However, from Mr. Kniskern's latest book, now on the Press, I quote as follows:

> In the absence of well secured leases any attempt to set out gross income beyond two or three years, leaves the zone of precision for that of general judgment, and such judgment can better be expressed through the capitalization rate.

Mr. Frederick M. Babcock in a recent monogram said:

> There is no way to tell future events. The best that an evaluator can do is to study past causes and effects and to presume that future events will probably be thus indicated by present discernible causes.

Again we quote from the volume of the same author just published:

> In forecasting, the predictions will have to be controlled by probabilities and plausibility. Each factor will be assumed to operate in an "average" or the most likely manner.

These excerpts would be misleading however, if it were not stated that both of these authors proceed to suggest safe methods for discounting future benefits in the way of net rentals. So much has been written by recognized authorities and so many warnings have been given that it would be trite and, as well, officious to attempt to add to the data and dictum already at hand. This thesis accordingly, confines itself to one theorum: The estimate of future benefits should be based upon statistical data as to past market movements as affecting real estate and an intensive study of the natural laws of economics, which study will measurably assist in discounting the future.

In my opinion, the very best we can do is to determine, first, if we are in a high or a low market; second, to establish what in our judgment is a fair average market under normal conditions and then to project this figure so established, into the future. It must not be the high and it must not be the low. Thus only can we strike an average which will, over a long period,

take up the slack between the zenith of prosperity and the vale of depression.

Immutable laws of nature have been analyzed with such mathematical certainty that astronomers can tell us what will be the position of certain planets centuries hence, but there is no fixed behaviour controlling economic phenomena and it is out of these phenomena that arise the inexorable exigencies by which rent values are established.

Finally, be it said: The appraiser must be a student of economics and of market history, and he must be possessed of an analytical mind if his forecasts are to be of value. He must determine the relation of any present condition to what should be a normal condition. In other words, he must stabilize the income value of the property in question and set the figure up as his norm rather than use such prices as maintain today or those tenable in some previous year or previous period of high or low values.

It is somewhere up the mountainside of hope, above the valley of the shadow of despond and below the sunkissed peak of a too great optimism that we will find for our travel and our travail, the safe road of conservatism for prophetic analysis of future benefits.

Burton Thompson, M. A. I.
Elizabeth, N. J., Jan., 1933.

Frank D. Hall — On The Prophetic Analysis of Future Benefits in Max Tieger's Appraisal

THE Prophetic Analysis of Future Benefits in Mr. Tieger's appraisal deserves commendation for the attempt to foresee probable future earnings — a recognition that rents of tomorrow are not the rents of today. I agree in principal that any sound appraisal is based upon an expectancy rather than present apparent realties and yet we who have in recent years seen our carefully projected prophesies of earnings smashed by an unexpected but complete change in the picture are inclined towards meekness and humility. We almost say that prophesy belongs to the gods, not man. Mr. Tieger projects his expectancy throughout the estimated economic life of the improvements — 32 years — at a time when we are asking ourselves if anyone knows what rents will be next week.

My thought of the moment is that if this appraisal came up to me for review in connection with an application for a five or ten year loan on the property I should ask myself "What does this man Tieger mean by *stabilized rents*?" What is their relation to the rents of 1928 and the actual rents which the tenants can pay today and stay in business? Taking a long-point view I should then say that somewhere between these two extremes a figure approximating stabilization can be found leaning more to present than past rents. As to the office rentals on the second and third floors I would further inquire as to the prospects of future competition in the way of modern office buildings because I have had some disastrous experiences in attempting to stabilize income of office rental space in two and three story walk-up buildings by the unexpected and apparently unwarranted construction of new, modern, elevator buildings nearby. I realize, however, that this is a threat not potent today and it is probably that Mr. Tieger had this in mind when making an allowance of 25% for vacancies on the third floor a wise attempt to forecast the rental resistance against walking up two flights of stairs when elevators are nearby in competing buildings.

Being satisfied that the stabilized rents were the rents that seemed dependable for the next two or three

years and that they were not much out of line with actual rents received today I would be inclined to accept them as a basis for capitalization and with my fingers crossed would probably decide that this is a $300,000 property.

Frank D. Hall, M. A. I.
New York, N. Y., Jan., 1933.

Ballard — **On The Prophetic Analysis of Future Benefits in Max Tieger's Appraisal**

THIS paper has been prepared on the "Prophetic Analysis of Future Benefits" which will accrue to the property at 101-103 Broad Street, Elizabeth, New Jersey, — the property appraised in the demonstration appraisal of business property by Max Tieger, M. A. I., Elizabeth, New Jersey.

The property is located on one of the principal corners in the retail district of Elizabeth, New Jersey, — the County seat of Union County, which has a resident population of 115,000 and a trading population of about 250,000, — is located within approximately fifteen miles of New York City, and may be termed a satellite city. The property was assessed in 1932 for $188,500, — $40,000 on the building and $148,500 on the land.

In my opinion the value of the land, approximately 2500 square feet improved in 1929 with a modern three story and basement steel frame, limestone front, store and office building, will have an average yearly increment in value of not less than 2% during the life of the present building which I estimate to be not more than twenty (20) years. The increment in the gross income of the property will also average 2% a year.

There will be a constant increase in the cost of operation and maintenance of the property and probably a substantial increase in the taxes to be paid. These increased operating expenses, maintenance and taxes, will probably absorb at least one-third of the increase in gross income.

The plot of land in question is one of the most desirable in the City, and the City itself is so favorably situated as regards future growth that I have no question in predicting a continuous increase above the present intrinsic value of the land. In round numbers I estimate the present intrinsic value of the land to be $200,000 and the building $40,000, or a total of $240,000 since I do not find sufficient evidence in the appraisal of the property to concur with the appraiser's estimate in round figures of the land value of $280,000 and the building value of $40,000 or a total of $320,000. Using the valuation I have suggested, the improvement bears a ratio of one to five to the land as compared to the appraiser's relation of one to seven.

I submit that in either case, the relation of improvement to this small area of land on the principal corner in a city of over 100,000 population, is convincing evidence that the useful life of the present building will not exceed twenty (20) years, — since on or before that time the best and highest use for the land will be a use in conjunction with the adjoining land, with a total area of approximately 10,000 square feet improved with a suitable building.

If the present intrinsic value of the land is $200,000, the figure which I have suggested, and if the average yearly increment in the value of the land is 2%, the total land value at the end of twenty years will have increased to $280,000, — or, if Mr. Tieger's estimate of thirty-two (32) years as the useful life of the building is assumed to be accurate, the value of the land at the end of thirty-two (32) years would be $332,000, or slightly

in excess of Mr. Tieger's estimate of the present value of the land, — approximately $320,000.

My reasons for assuming that the present intrinsic value of the land is $200,000 are as follows: the gross rentals set forth on page 233 of the appraisal under the title "justifiable annual rent" indicate that they are not the present rentals but a statement of rental expectancy. The reference note at the bottom of page 233, a quotation from Kniskern, does not seem to me to be applicable in this case where the indication is that rental expectancy figures have been used, since the reference seems to be designed for use only in discounting abnormal rentals where it is evident that they cannot be permanently maintained.

I suggest the appraisal should include the present total gross actual income as illustrated in the Real Estate Appraisal Form, Schedule B, Annual Income, line 6,—since unless this information is included I should feel, if it were my appraisal, that I might be taken to task for not complying with Paragraph B of Article 5, Section 3, of the Standards of Appraisal Practice.

I suggest also that the total operating expense is lower than I should care to use, since it should include a more generous allowance for building maintenance and repairs.

It is reasonable to assume that the taxes may not increase particularly during the next five years, after which time there will probably be a much greater increase in the taxes than is indicated in the increase in the total annual expense figure used, $9,300, in the first year, and an average over the thirty-two (32) years of $10,113 a year.

My comments in regard to the facts set forth in the demonstration appraisal are included only for the purpose of presenting the reasons and facts which I have used in forming an opinion as to the probable future value of this property. The opinion which I have offered is academic only, since I have had neither the time, information, nor knowledge necessary to make an actual appraisal of this property.

W. H. Ballard, M. A. I.

Boston, January, 1933.

Kniskern — On The Residual Process in Max Tieger's Appraisal

SHOULD land be made residual to the improvement, or the improvement residual to the land? In connection with this question I would like to quote from a recent publication of my own on the subject of *Real Estate Appraisal and Valuation,* which appears under the heading of "Capitalization":

"The importance of an improvement to the earning power of land is somewhat analogous to the catalyst in chemistry. Two chemicals may be placed together in a vessel with no reaction. However, whenever the third chemical or catalyst is introduced action takes place immediately. In this analogy we have the unimproved land and its potential earning power, but not until a building is erected does the combination of the first two produce any results.

"Whenever any building is erected upon a piece of land an obligation is thereby imposed upon the land to repay the investment in the building and to pay interest thereon so long as the building exists. Furthermore, the building is an exhausting asset, while the land is permanent and it will continue to have value after the present buildings are gone. For these reasons the first charge against income will be for the building and a deduction will be made therefrom sufficient to pay interest on and to

return the investment in the building. The residue income will be allocated to the land.

"There is a further reason for this. As has already been pointed out, vacant land has only potential value. City land is of no actual value to mankind until it is productive, and it cannot be productive until it is improved. Improvement, that is the erection of a usable building, is an inherent and essential preliminary to earnings from land. The land, then, must first compensate capital for the erection of this prerequisite, the building, and accept for itself the residue produced by the combination. This obligation does not extend to the support of an over-improvement or an improper building.

"It may be said that vacant land sells for a price and therefore has value without improvement, but it must be remembered that each purchase of vacant land looks forward to the ultimate improvement thereof. This improvement may be contemplated by the immediate purchaser or he may contemplate selling to another to improve. It is a fact, nevertheless, that the background behind the price in each transaction in vacant land is that value which someone can ultimately develop by erecting improvements. Vacant land that has no reasonable expectancy of profitable improvement has no value and brings no price."

Philip W. Kniskern, M. A. I.

New York, N. Y., January, 1933.

Goldfarb — On The Residual Process in Max Tieger's Appraisal

THE question whether land value should be made residual to the improvement or vice versa is a subject which has recently been bothering the appraiser of income property.

In my opinion there is a definite procedure to follow, namely, to make the land residual to the building. This is especially true in this day when determination of land values is difficult, when sales are few and far between, when the rental situation is chaotic and undetermined, and when the general elements that go to make up value are unstable.

In determining any mathematical solution it is essential to start with the known facts and proceed to ascertain the unknown. When the appraiser has gathered all the facts that he can avail himself of, the question that he must determine is — the value of the property, and for the purpose of expediting his analysis he divides his value into land and buildings. Where the improvement represents the highest and best use of the site as determined by the experience and judgment of the appraiser he starts to evaluate that improvement first. In order to arrive at the value of the improvement it is merely necessary to find the cost of replacing the building, less physical depreciation as of the date in question.

The cost of the building is a fact easily ascertainable by the appraiser. Having evaluated the building, the appraiser now proceeds to find the value of the land. However, where the improvement, in the judgment of the appraiser, does not represent the highest and best use of the site, what shall the appraiser do? The cost of the improvement certainly does not represent its value in that case. The improvement may be obsolete; it may be over-improved or under-improved. In any event, the appraiser certainly cannot start with the improvement in that case and make it residual. Shall he start with the land and make the building residual? If he were to start with the land the question would arise — where shall he start and how shall he start? According to Mr. Tieger's

statement, there has not been a sale in this vicinity for eight years, and, therefore, sales do not furnish sufficient data to determine the value of land, and if there were a few sales certainly I am not willing to permit the minds of one or two purchasers to set the value of the property in the vicinity. Sales do not always determine what is a fair market value of the land, as is now proven by the horrible deflation that has taken place from the sales of the years 1925, 1926, and 1927, and certainly the sales that have taken place during this depression in 1930, 1931, and 1932, are no criterion of value.

So, again in my mind we start with the building, and as the building is obsolete and does not conform to the appraiser's idea of the highest and best use of the site, the appraiser should determine what the highest and best use of the site is and erect a hypothetical building on that site to conform with his opinion of an adequate improvement for the site.

Usually the hypothetical building is unnecessary; usually the appraiser can find adjoining the property in question in the same locality a building representing the highest and best use of the site, and he can make an appraisal of that property, making the land residual, and in that way determine the value of the land. Of course, in the case of the property under appraisal having an obsolete building, that building becomes residual to the value of the land determined by the erection of the hypothetical building or by the appraisal of the adjoining property containing the improvement representing the highest and best use of the site.

So, in all cases, either directly or indirectly, land value should be residual where an income property is appraised.

Morris Goldfarb, M. A. I.
Perth Amboy, N. J., January, 1933.

Gray — On The Residual Process in Max Tieger's Appraisal

THE improvement is the residual value, in an expert real estate appraisal, because it merely represents the mathematical difference between the market value of the land, if it were not then improved, and the market value of the property as improved. As a matter of fact, I know of no practical method of separating the land and the improvements in an expert appraisal. It can, however, be done hypothetically, and that presents the problem of working it out by the most logical method. I maintain that the land represents an intrinsic value and the improvements an artificial value. If you eliminate the improvements, the land retains its value and remains in the same physical state, as it existed before the improvements were built. But to remove the improvements from the land, the value or building cost is completely destroyed to all intent and purpose. Even in a case where buildings are susceptible to being moved, intact, to another location, it is generally found to be an unprofitable venture. A building once moved from one location to another is always the object of deep suspicion from the sales viewpoint. The practice of separating land and improvement is only a matter of custom, and I believe originally intended to ascertain the relative percentage that the land bears to the total value.

There has been a generally accepted conclusion that when the land represents 25% or more of the total value, real property will maintain a more equal worth, over a span of years, and will experience less fluctuation in value, income, and refinance probabilities. If this theory is sound, and I believe it is, then the separating of the land and the improvements in an appraisal becomes one of the qualifi-

cations of the appraiser. That may be the very purpose for which the client is buying an appraisal.

I am not saying, however, that any member of this Institute should attempt to sell, under the guise of an appraisal, any theory of value a customer may demand, if not practical, economic, scientific, and good practice. I do believe, however, that it is good practice to separate land and building—but you should be very careful how you do it.

I do not believe that any practical appraiser is capable of finding sound value by the method of valuing the land and valuing the building separately and adding them to obtain the value. I believe that the first and the only method is to find the total value. In other words, during your deliberations you must ascertain the value of the property as you examine it. Then, to be efficient and prudent, to analyze and re-check your conclusion, by any method which you believe to be fair and equitable to yourself and your customer. Please bear in mind that I am approaching this subject solely from the sound value viewpoint, and want to state here that, in my judgment, the most confusing element and one that seems to be the most difficult to understand, is that costs of buildings (fundamentally) are irrelevant and immaterial. If that statement be true, and I believe it is, then the improvement must be residual to the land.

I want to state, however, that I know of no way to make an appraisal of a property that has no demonstrative market value, such as a church, a town hall, public library, courthouse, etc., except by the capitalization method on both land and building. If, however, I were given a job under this classification, I would treat the land very conservatively and apply the same principle to the cost of the building and be very severe on my depreciation, as a matter of duty.

An exception of this kind, to a rule, merely proves that any theory that has no exception is too simple to require expert application.

George H. Gray, M. A. I.
Brooklyn, N. Y., January, 1933.

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du Bois — **Response to Comments on "Severance Damage to an Apartment Site"***

The writer appreciates the frankness of the critical discussions offered by Messrs. Register, Newhall, and Hall of the appraisal which appeared in the January "Journal." Unless critics freely speak their viewpoints, this department of our publication will fail of its purpose. The writer desires to discuss some of the points raised in the criticisms so that further benefits will follow to readers:

No plat showing present buildings or any statement that their life had terminated.

The appraisal stated: "These (existing) buildings are not affected by the street widening and need not be considered in this report."

No supporting data re cost of apartment building and furnishings, re rentals assigned, re value as a business site in event of re-zoning.

The appraisal was not made as a "model"; and, as published, was abbreviated in certain respects; hence certain omissions. Some data were omitted also due to the practical limitations placed on appraisers sometimes by the amount of fees obtainable, which may not warrant as full a *written* presentation as may be desired. Such data can be given verbally, however, if necessity arises for

*See page 153ff in the January 1933 issue of this Quarterly.—Ed.

amplification. The omissions do not necessarily indicate that the data has not been gathered.

Phenomena of declining earnings in aparatment property not considered.

The report stated: "The analysis indicates possible land earnings of $4,449 per year, assuming a constant level of gross earnings and deductions as set forth, which conditions do not . . . exist in such types of property." It also stated that the income analysis was but one factor considered. It is the writer's opinion that capitalization analyses are but "tests" and not exact measures of value, especially where apartment structures are projected, and hence are not to be relied on to the exclusion of other considerations, particularly prices at which competitive sites can be purchased.

No statement as to when proposed structure could, justifiably, be erected.

A definite statement might well have been made; however, the use of the present, rather than future, tense in the language on page 157 was intended to indicate the structure could be properly erected immediately.

Unless appraiser would recommend purchase for $11,808 of 15' feet on Poppy Lane by owner of corner 130 feet, estimated damages too high.

The test of reasonableness of estimated damages is not the one raised by this criticism. There is quite a difference between *purchasing* 15 feet to add to existing holding, and *estimating damages* resulting from the taking of 15 feet by condemnation; and it is irrelevant and immaterial, as well as incompetent, to prove anything, to inquire, in an eminent domain action, if the appraiser would recommend the purchase of the condemned land at any particular price. The defendant is entitled to the highest price representing the value of land taken, plus severance damages; if he were buying the land, however, other factors would enter to influence his viewpoint, and he would probably be unwilling to buy at the highest price; indeed, the appraiser, acting as investment counsellor, would doubtless recommend a lower price, realizing that while the 15 feet might be worth $11,808 to the Arterial street owner, there perhaps would be special reason for him to buy it, and, furthermore, that the 15 feet might be worth only $1,200 to the owner adjoining on the east (in a single-family residence zone), and almost worthless by itself due to lack of utility, so that in the open market it might be valued at no more than, say, $3,000 — the price it would bring falling between $11,808 and $1,200 and being arrived at in consideration of factors impelling the seller to sell and the buyer to buy, and depending largely upon their individual shrewdness and skill in bargaining. However, attention is directed to the statement on page 160 which says the average square foot method of valuing land taken is used because other parcels to be condemned will be so valued. That method results in overvaluation in the case of apartment sites and many other types of properties; but the appraiser often finds himself in the position of having to estimate the amounts which should be awarded one owner in view of awards which will be made to others affected in the same proceeding. In this particular case the referees awarded a higher figure than that fixed by the writer for the land taken, and made no allowance for severance damage (No appeal was taken). They even telephoned the writer to see if he wanted to raise his figures before they made their report.

The "before and after" method should have been used.

The writer favors that method over the "average sq. ft." method, and would have used it in valuing the land taken if other properties affected were treated in the same manner. However, he does not believe in this case that the severance damage could have been estimated by that method, because the land was not actually improved with an apartment structure. Capitalizations with *projected* apartment buildings (not *existing* ones) are not to be relied upon implicitly as *measuring* land value, but are useful in indicating what the value might be if the particular building existed, and are helpful in reaching conclusions as to the fair value of the land in its vacant status awaiting profitable utilization. The great variety of floor plans possible, each of which would produce a different result in the income analysis; and the wide variations in resultant capitalized values following upon slight variations in the items comprising the income and outgo schedules, renders the captalized value unreliable, except in approximation, and forces supplemental reliance upon other known factors, upon experience, and upon sound common sense. In the case at hand, the appraiser tested the application of a "before and after" analysis, concluding, after much thought, that it was not practicable to base a claim on it. Feeling, however, that there was some loss of "plottage" value (a severance damage), he decided to present the referee's evidence of how in one specific particular (which, he felt, they could readily grasp) the lessening of the depth by 15 feet would depreciate the value (i. e., the potential earning ability) of the remainder. The increase in unit costs of management was the best way to do this, he belevied, after much study of the problem; for, regardless of how other factors might be affected, it seemed undeniable that unit management costs would be increased, and therefore a severance damage would result. Mr. Hall says that possibly some of the lower priced rental space would be lost. That would depend upon floorplans and layouts possible with the different depths of land before and after the taking, and emphasizes some of the things pointed out above. A pertinent statement by Frederick M. Babcock from his new book, *The Valuation of Real Estate* (reviewed in this "Journal"), is in point: "Valuation technique can do more than give approximations, and a better technique serves to remove only the most glaringly inaccurate elements involved in pure guessing. . . . Thus the valuation processes . . . cannot be offered as more than devices to guide judgments. . . ." (Pages 1 and 2.)

Ayers J. du Bois, M. A. I.

Los Angeles, January 20, 1933.

McLaughlin — On "Severance Damage to An Apartment Site" by du Bois

I have read with interest the appraisal by A. J. du Bois in the January issue of the "Journal." I have also read the comments following the article. It seems to me that the letter from Mr. Newhall on page 164 hit the nail on the head. In my opinion the owner of this property was only entitled to be paid what the land was worth at the rear of the lot on the Poppy Lane frontage, as he still has the frontage on Arterial street, and the buildings are not damaged. As a matter of fact we have a law here to this effect. When the frontage is not taken from the owner he is only entitled to be paid on the value of the rear portion of the lot.

It seems to me that valuations such as this one should not be encouraged. I wonder why he did not build an

office building or theater in theory on the lot, as he hints that this district could be used for commercial purposes. Eventually by that means he could have shown the revenue much higher. Such evidence as this before one of our Courts would not carry weight, that is, figuring on what the property might produce on some kind of an improvement that is not even projected.

Frank McLaughlin.

Toronto, January 9, 1933.

Schmidt — On Valuation of Vacant Land

The purchaser willing to acquire vacant land at a fair price has almost disappeared in our urban communities. It, therefore, has become practically impossible to appraise in terms of present money, the worth of the future benefits of land ownership which is the measure of value. Present conditions render the task of the appraiser of vacant land a most difficult one. Normally the appraiser has at his disposal many facts and past happenings which, by projection into the future, will form the basis for the ascertainment of present value with a reasonable degree of certitude. Even today there are data furnishing a good index to the present money worth of homes; the same cannot be said, however, of vacant land. Regardless of these facts it remains equally true that vacant land has fair value even though that value is not realizable in money.

Various elements deserve consideration in arriving at a conclusion, among them:

1. Reproduction cost represented by some fair sum for raw land plus the outlay for the various services possessed by the premises in question.
2. The trend towards appreciation or depreciation in the neighborhood itself.
3. The desirability of the plot, determined largely by the scarcity of similar property offering the same conveniences.

There are likewise general conclusions which must be formed on a variety of subjects, such as—

1. The relationship which commodity prices and wage scales bear to the price of land.
2. What sound judgment can be formed regarding the rate of growth of the specific community. It is obvious that the value of lots in a community losing population will finally reach almost a vanishing point; whereas if the community is growing the upward trend of lot values will be accelerated proportionately.
3. The probability of national population increase has a bearing on land values. Will the immigration policy adopted by our country, diminishing the flow of new families into America, result in a stabilization in our cities?
4. The result of difficulties had by such a great percentage of our people, occasioned by decrease in incomes now insufficient to meet mortgage interest and amortization requirements, will probably occasion a horror of debt on the part of the average citizen, with the result that there will probably be a tendency towards smaller homes and less expensive land. The betterment of transportation, of course, makes greater distance possible. Such a movement would tend to lower the previously existing relative value of close-in land.
5. Will the United States have some form of inflation tending to raise prices?

As a general proposition it seems probable that the rate of growth of cities will be greater in the future than in the past despite restricted immigration. The "Back to the Farm" movement was evidently misdirected eco-

nomics. The farmer per unit can produce many times the amount of food that he could twenty years ago, — due to scientific knowledge increasing the productivity of land and also to the bringing of machinery to the farm in a major way. The capacity to consume food is limited; whereas man's appetite for acquisition of manufactured things is limited only by his ability to pay. It consequently would appear logical that the movement from the farm to urban centers will be greater in the future than in the past, since a lesser number of food producers can supply our needs. If this analysis is correct there is reason to expect that our cities and towns as a whole will continue to grow in population.

It would seem at this instant that we have gone back to 1913 prices or thereabouts. Values then existent probably will represent about our low in the era through which we are passing. The determination of our people to achieve economic progress and to better the standards of living should bring us back to some sane basis of business before many more months are passed. During our prosperous years there was undue inflation in most communities; we must, therefore, recognize a new base, not of course the present deflated base, but a normal point between the high and low.

It is not easy to assign fair value to vacant land today. However, there are various criteria, past experience and the probable operation of economic laws, which furnish a guide to present worth. Appraisals should reflect a thoughtful consideration of *all* elements of worth, rather than attempt to designate the cash sum probably realizable at the moment from any specific piece of property.

Walter S. Schmidt, M. A. I.
Cincinnati, O., Feb. 23, 1933.

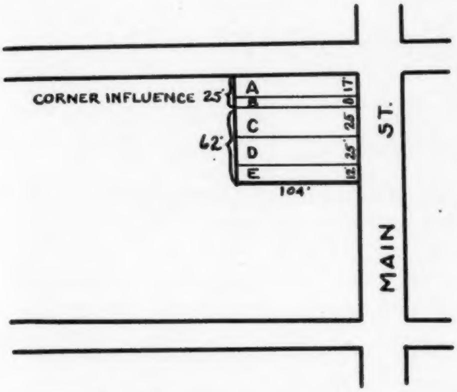
Gitterman — On Corner Influence

THE corner influence problem on page 138, Volume 1, Number 2, apparently remains unsolved, and I therefore wish to submit an answer for consideration, predicated upon my experience in the Borough of Manhattan, City of New York.

After a study, covering thousands of properties, and the store values in locations throughout the City, I prepared a chart showing the influence of corner values and the added plottage increment derived by virtue of increasing values on side streets, compared to the main thoroughfare, which leads me to the following conclusions:

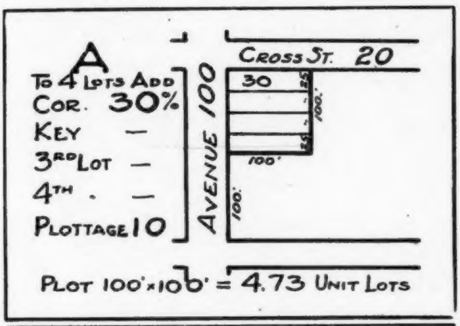
1. Corner influence where commercial property can be built has a minimum value of 15% and extends over the 25 ft. corner lot.
2. The influence would still carry beyond the 17 ft. parallel on a plot having a front foot value of $3,250.00 on the main street and a $500.00 front foot value on the side street.
3. The $500.00 front foot value on the side street proves that the property is not in great demand and hence the low increment for the advantage of light, air and access, particularly for shipping purposes which produces a minimum of 15% accretion.

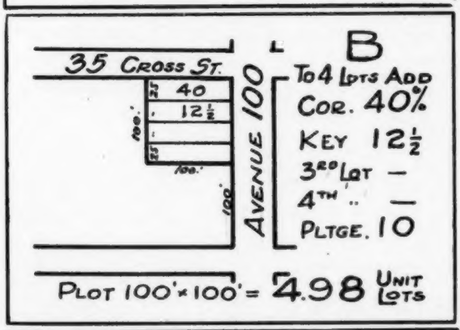
As of general interest on this particular subject I submit herewith some charts showing the increments produced by corner influence and the resulting effect upon each of the four 25 ft. corner units under six different ratios between the values of the main street and the cross street. These results are based on the studies above referred to.

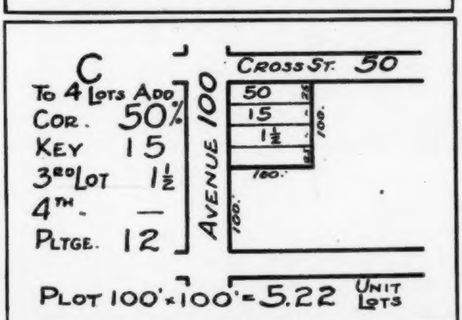


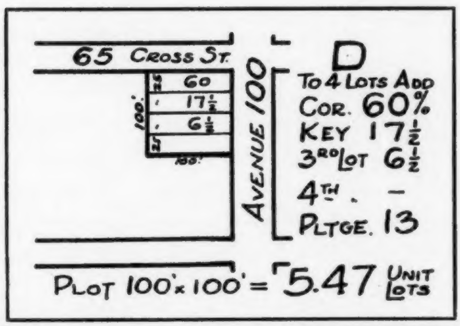
PLOT 87.37 x 104		$326,700.
CORNER INFLUENCE	15%	
OVER 25 x 100 ONLY		
PLOTTAGE	10%	
CORNER 25 x 104		93,500.
CORNER INFLUENCE	15%	
LAND UNDER STORE 17 x 104		63,750.

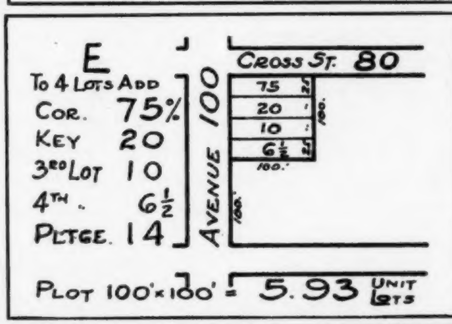
Q.E.D.

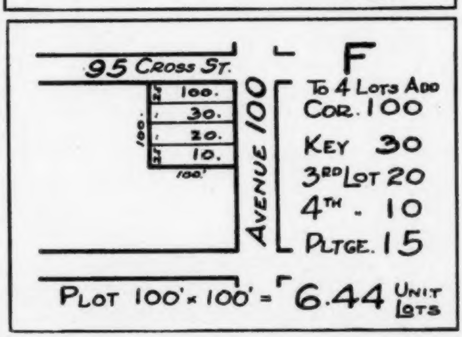












Gitterman — On Air and Sub-Surface Rights*

450 LEXINGTON AVE. N.Y.C. (U.S. POST OFFICE)

BLOCK 1280 - LOT 90

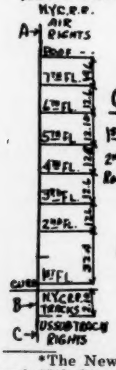
AS OF OCT. 1. 1929	AS OF OCT. 1. 1930	AS OF OCT. 1. 1931	AS OF OCT. 1. 1932
LAND VALUE $4,980,000	LAND VALUE $4,725,000	LAND VALUE $4,260,000	LAND VALUE $3,720,000
AVE. 11.33 UL @ $275M. 3,120,000 ST. 7.63 " " 140M. 1,065,000 PL. 4.83 " " 70M. 340,000 PLOTTAGE - 11%. 455,000	AVE. 11.33 UL @ $260,000. 2,950,000 ST. 7.65 " " 135,000. 1,030,000 PL. 4.83 " " 65,000. 315,000 PLOTTAGE - 11% : 430,000	AVE. 11.33 UL @ $235,000. 2,665,000 ST. 7.65 " " 120,000. 916,000 PL. 4.83 " " 60,000. 290,000 PLOTTAGE - 11% : 390,000	AVE. 11.33 UL @ $206,000. 2,325,000 ST. 7.65 " " 105,000. 800,000 PL. 4.83 " " 52,500. 255,000 PLOTTAGE - 11% : 340,000
BLDG. VALUE 2,480,000	BLDG. VALUE 2,360,000	BLDG. VALUE 2,045,000	BLDG. VALUE 1,850,000
6,260,000 CU. FT. @ 60¢ : 3,756,000 DEPREC. 17 Y @ 2% : 1,276,000	6,260,000 CU. FT. @ 59¢ : 3,690,000 DEPREC. 18 Y @ 2% : 1,330,000	6,260,000 CU. FT. @ 52.8¢ : 3,300,000 DEPREC. 19 Y @ 2% : 1,255,000	6,260,000 CU. FT. @ 49.2 : 3,080,000 DEPREC. 20 Y @ 2% : 1,230,000.
DUPLICATION VALUE $7,460,000	DUPLICATION VALUE $7,085,000	DUPLICATION VALUE $6,305,000	DUPLICATION VALUE $5,570,000
N.Y.C. R.R. RIGHTS* 1,580,000	N.Y.C. R.R. RIGHTS* 1,705,000	N.Y.C. R.R. RIGHTS* 1,675,000	N.Y.C. R.R. RIGHTS* 1,600,000
SUBSURFACE $77,000 . 1,280,000 : B+C RENT CAPIT. @ 6% AIR RIGHTS - 10% : 500,000 - A OF LAND VALUE VALUE BELOW TRACKS - 200,000 (DEDUCT)	SUBSURFACE $85,000 - 1,420,000 - B+C RENT CAP. @ 6% AIR RIGHTS - 10% 475,000 - A OF LAND VALUE VALUE BELOW TRACKS - 190,000 - C	SUBSURFACE $85,000 $1,420,000 - B+C RENT CAP. @ 6% AIR RIGHTS - 10% 425,000 - A OF LAND VALUE VALUE BELOW TRACKS - 170,000 - C	SUBSURFACE $85,000 : $1,420,000 : B+C RENT CAP. @ 6% AIR RIGHTS - 10% , 370,000 : A OF LAND VALUE VALUE BELOW TRACKS - 150,000 : C
APPRAISED VALUE $5,880,000	APPRAISED VALUE $5,380,000	APPRAISED VALUE $4,630,000	APPRAISED VALUE $3,970,000
ASSESSED VALUE - 1930	ASSESSED VALUE 1931	ASSESSED VALUE - 1932	ASSESSED VALUE 1933
LAND $5,350,000 BLDG. - 1,850,000	LAND - $6,025,000 BLDG. - 1,475,000	LAND - $6,025,000 BLDG. - 1,475,000	LAND - $6,025,000 BLDG. - 1,475,000
TOTAL $7,200,000	TOTAL - $7,500,000	TOTAL - $7,500,000	TOTAL - 7,500,000

*SUBSURFACE RENT IS TAKEN AS 1/2 OF THE LAND TAX + 1/10 OF THE BLDG. TAX.
AIR RIGHTS ARE VALUED AT 10% OF APPRAISED LAND VALUE.
VALUE BELOW TRACKS IS TAKEN AT 4% OF APPRAISED LAND VALUE.

330111

NO DOUBT THE TAX ASSESSOR HEARD THE WELL CIRCULATED RUMOR, EVEN AS YOU OR I, OF THE CONTEMPLATED PURCHASE BY THE GOVERNMENT.

ABOVE UNITS DERIVED FROM BEST OBTAINABLE INFORMATION WHICH WILL BE SUBMITTED FOR EXAMINATION.

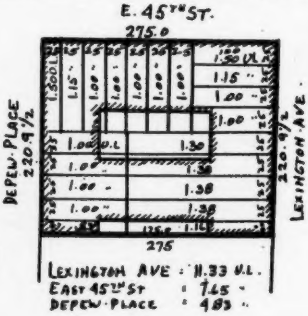


CUBAGE ANALYSIS

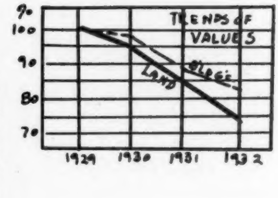
1ST FLOOR (6,800 x 33.0)	2,250,000
2ND TO ROOF (51.10 x 77.6)	3,960,000
ROOF BLDGS. (5,000 x 10.0)	150,000
TOTAL	6,260,000 CU. FT.

NOTE: BUILDING STARTED IN 1906 AND COMPLETED IN 1912

E. 45TH ST.
275.0



LEXINGTON AVE : 11.33 U.L.
EAST 45TH ST : 7.65 "
DEPEW PLACE : 4.83 "



*The New York Metropolitan newspapers recently carried the news that the corner of Lexington Avenue and 45th Street, New York City, had been sold to the United States Government for $9,000,000.00 for a United States Postoffice Building. Mr. A. N. Gitterman of New York City, submits the accompanying interesting study of the values of this parcel for each year from 1929 to 1931 and compares duplication values, appraised values, and assessed values. The treatment of air and sub-surface rights is of interest. A Government official in commenting on the purchase price stated that sub-surface rights were evaluated substantially on the basis of ratio which is ordinarily used in air rights appraisals, namely 15%. In this particular case the sub-surface rights were figured at 14.4%.—Ed.

Professional Ethics

***Ostendorf* — On the Use of the Institute Emblem and "M. A. I."**

THE purpose of this discussion is to attempt to define the proper manner in which to use the designation "M. A. I." by persons who are Members of the Institute, and then to define the proper use of our emblem or seal.

Article Four of the By-Laws of the Institute says in section 1:

> "All members of the institute may identify themselves by the initials M. A. I. which shall be the abbreviation for the words 'Member Appraisal Institute'.
>
> Members may use these initials following their names for any professional purpose, correspondence, etc., as follows: 'John Doe, M. A. I.'"

In calling this matter to your attention at the request of the Institute, it may seem that we are concerning ourselves about two relatively insignificant matters. However, the creation of the symbol or mark of identity is a serious matter, particularly in a vocation that approaches the professional such as ours. Marks of idenification are used to single out a special class of persons or things; and it is a real obligation with us at the beginning of our career as an Institute to move in a manner and designate ourselves in a way that will have the respect of the public and at the same time will so mark each one of us as to put us under obligations to live up to a high code of business morals.

Symbols such as M. A. I. in time, we trust, will signify to engineers, architects, investors, attorneys, et al., a special type of study, preparation, training, and expertness. Upon these three letters and upon the seal may depend the public interpretation of ourselves. Consequently, it is well in this initial stage specifically to set forth again the limitations of use so that abuse will not tend to destroy the intended significance and responsibility that goes with the three initials and the seal.

I do not want to over-emphasize the importance of these two items of constitutional and by-laws routine; but, on the other hand, I do not want us to allow ourselves to under-rate the potential force they have for making us worthy in the eyes of the public, or, — improperly used, — of making us absurd in the eyes of the public.

Again I refer you to Article Four, part of which I have just quoted.

Section 1, quoted above, specifically states that a Member may use these initials in a professional capacity. The entire matter can now be disposed of by emphasizing the fact that a Member may use these initials.

Certainly there is no possible way that false dignity can be thrown upon any corporation or partnership through the use of the three initials M. A. I. Only *individuals* are allowed to be Members of the Institute and only *individuals* may be dignified with the use of the initials M. A. I. Certainly it will be a breach of ethics, not to say good taste, if a corporation or partnership were to attempt to make capital out of the professional standing of one of its Members.

If a Member is also part of a corporation or a partnership and desires to have it known that he is a Member of the Institute, his name may appear upon their stationery or other places where the firm name is used, followed by the initials M. A. I. Even this use certainly should be in a most dignified

manner. Professions, or those attempting to create a professional plane, should not create blatant advertising material. This reminder of Section 1 of Article Four quite obviously shows that the word "Member" positively defines the intended use of this mark of appraising ability.

I might say that if an appraisal form were filled out from the office of Andrews & Blake, a partnership, that it should be signed by A. A. Andrews, M. A. I., if it is the individual work of that appraiser, and underneath his signature might properly then come the firm name. Allow me to say this, that a clear conception of what the word "Member" means in the American Institute will immediately place the proper use of the words M. A. I.

With reference to the Institute emblem, I would call to your attention the fact that we have yet made no provision in the By-Laws for the use of such emblem. Consequently, I am going to offer a resolution in these remarks which it is intended shall be submitted to the Governing Council for consideration.

The Institute created an emblem, and has issued it as a symbol or button or pin for the use of each member. It is a mark of a group and should be used as a group symbol, in a sense entirely different from the words M. A. I.

M. A. I. indicates a Member of the Institute, and the emblem represents the regimented efforts and expression of the Institute.

The emblem is the mark of the entire organization upon an act or acts. It should not be used by any individual in any way or by any Member of the Institute or anyone else in any way, shape or form, except that a Member is permitted to wear, and is urged to wear, a pin or button that carries this emblem as a symbol of identification.

Upon the certificate of election, which each Member has, appears the emblem because there the entire organization puts its stamp of approval upon an individual.

In a similar fashion the President, Secretary, and other officers or authorized persons in putting forth the acts of the organization, use the emblem to show the unity and mark of the group as differentiated from the mark of the individual evidenced by the initials M. A. I.

Briefly, to summarize this second item, the emblem should be used at the direction of and by the Institute itself and not its individual Members. The resolution to amend the By-Laws so as to include a consideration of the emblem, which I expect to submit, reads as follows:

> WHEREAS, the American Institute of Real Estate Appraisers should have an emblem indentifiing its actions, which may also be used as a mark of identification by its members, and
>
> WHEREAS, there exists now an accepted symbol, that is being used for this purpose, NOW, THEREFORE,
>
> BE IT RESOLVED that the American Institute of Real Estate Appraisers amend Article Four, Section 1 of its By-Laws to read as follows:
>
> The Institute shall have an emblem approved by the Governing Council which shall be used by the Institute upon its official business, shall be used on the certificate of election of each member, and which also in turn may be used by each member of the Institute as a badge.

E. L. Ostendorf, M. A. I.

Cleveland, Ohio, Jan., 1933.

Bowen — On the Use of the Institute Emblem and "M. A. I."

THE question of ethics in connection with the use of M. A. I. in appraisal reports and on letters where an individual is a member of a firm, I believe to be very important.

As I see it, membership in the appraisal institute is individual and the initials M. A. I. are intended to become the significant designation of a competent workman just as the initials after the name of an architect or an engineer, and just as "Realtor" was intended to designate a competent real estate man. Now, while the term "Realtor" was intended to apply to individuals it has been allowed to apply to partnerships, firms, corporations, whose members are members of a board which board is a component part of the National Association of Real Estate Boards. From my standpoint, this has had a very serious effect in weakening the connotation of the term in the minds of the public.

Let me take as an illustration a recent case which arose in Buffalo. W.E.B.R. is one of our broadcasting stations—yet is essentially a seller of advertising in connection with the broadcasting. William Doerr, Jr., a man who had been actively connected with the Buffalo Real Estate Board for a number of years, organized the W. E. B. R. Real Estate Service Corporation. This Corporation is taking the listing of properties for rent and for sale and is broadcasting the descriptions as a means of selling and renting real estate. Mr. Doerr is, at the present time, an active member of the Tonawanda Real Estate Board and, as such, entitled to use the appellation "Realtor". I believe so far as the method of operation of the company is concerned that there is nothing that is unethical in the method, but the public thinks of W. E. B. R. as a broadcasting station. When they hear the "Realtor Hour" under the name of W. E. B. R. it raises a question in their minds as to how a broadcasting station can properly be a Realtor, and as a matter of fact they fail to pay any attention to the balance of the technical corporate name. The local reaction of both individuals and real estate men has been that W. E. B. R. had no right to use the term Realtor. Yet as a matter of fact we have Dexter P. Rumsey Company, being operated at the present time by Adrian Smith, using the term Realtor with everyone's approval because Mr. Adrian Smith is a *bona fide* member of the Buffalo Real Estate Board. Well, now, if Mr. Smith is to be allowed to attach the term Realtor to the Dexter P. Rumsey Company because he is a member of the National Association of Real Estate Boards, then there can be no real reason why William Doerr, Jr., should not apply the term Realtor to the W. E. B. R. Real Estate Service Corporation.

As a matter of fact, I do not believe that either use of the word is sound, but it would be almost impossible now to go back and change the situation so far as the use of Realtor is concerned. A number of years of habit and custom have established hundreds of men in their right to apply the term Realtor to the corporate or partnership names under which they are doing business.

Consequently, I believe the Appraisal Institute needs at the very outset to recognize that fallacy which has allowed the application of an individual term to a corporate entity. I think it should be recognized that no firm or no corporation should be allowed to use the letters M. A. I. or to use the institute emblem. On the other hand, I do not believe we should deny the value of these to partnership or corporate organizations. In my state, architects are practically estopped from forming corporations for the conduct of their business because of the very definite insistence both so far as the architects' association is concerned and so far as

the laws of the state are concerned from operating an architectural business except on an individual or partnership basis, and, even where partnership, each member of the partnership has to be an architect. I believe the use of our emblem and the use of the designation M. A. I. would much more appropriately follow the lines used by various engineering organizations. For instance, if we take the name of a fictitious firm, let us say, The Real Estate Appraisers Corporation, I do not believe that it would be proper for the Real Estate Appraisers Corporation to put M. A. I. after its name or use the emblem of the American Institute of Real Estate Appraisers as its emblem. I do believe that the emblem of the American Institute of Real Estate Appraisers might be put on the stationery of such a corporation with the name of John Jones, M. A. I. member underneath the emblem indicating clearly through what channel the corporation was justified in displaying the emblem and I believe that the appraisals of such a corporation should not be signed by the Real Estate Appraisers Corporation, by Jones Jones, M. A. I., but should be signed John Jones, M. A. I. by the Real Estate Appraisers Corporation. After all, membership in the Appraisal Institute is individual. Furthermore, any appraisal is an individual opinion in the last analysis and as such the insignia and emblem of the Appraisal Institute and the method of preparation of appraisals and correspondence along this line should be kept on a strictly individual basis.

P. V. Bowen, M. A. I.
Buffalo, N. Y., Jan., 1933.

Gray — On the Use of the Institute Emblem and "M. A. I."

THE purpose of the Institute is to foster the highest standards of appraising and to give that business a professional status. In order to do so, this Institute is adopting a code of ethics and establishing reasonable rules of procedure.

Its membership is individual and therefore the responsibility, in ethical matters and rules of procedure, is directly upon the group of individuals, who constitute its membership.

Appraising the value of real estate is not an exact science and the final result of an appraisal is partly a matter of individual judgment, exemplifying that element of acquired knowledge, practical experience and training, which only the individual possesses. If the title of M. A. I. implies a degree of appraisal ability and responsibility, its use in business can only be individual, in good practice, and should be apart and separate from corporate entity. The mere fact that the individual may be an officer of a corporation, does not change his status.

It becomes quite essential and apparent, that a reasonable requirement of the Institute should be that real estate appraising be regarded as an individual accomplishment and that all written reports of such appraisal matters, be certified by individual signatures. I believe that by this requirement, we shall be following very closely, the method of other professional societies and as a result, will accomplish the best standards of attainment toward public recognition for the appraisal business.

The use of M. A. I. and of the Institute emblem is identical and the same rule should be applied to both.

If a Member is an officer of a corporation, then that fact, of course, can be made known in any way, so long as it does not change the individual endorsement, to a corporate act.

George H. Gray, M. A. I.
Brooklyn, N. Y., January, 1933.

Levy — On Dishonest Appraisals

I PRESUME that the question concerns dishonest appraisals so far as the morality of the appraiser is in-

volved rather than his ethics. If this is the case, then I presume that an appraisal reporting a value which the appraiser knows to be above or below a true value might be considered dishonest. This might be particularly so if it were disclosed that additional compensation over the usual fee were paid to obtain such an appraisal. Either of these situations, however, might be very difficult to prove. Another situation which might be considered dishonest could concern the issuance of an appraisal report by an appraiser having an interest in the property appraised without disclosing such interest in the appraisal report. Still another might be the issuance of a report when the compensation is contingent upon the amount of the appraisal, or the character of the opinion expressed.

The Standards of Practice recite that it is unethical for an appraiser to issue an appraisal report on an investment construction project with such value predicated on assumed rentals and/or expense at variance with the probable market at the time at which the reported value obtains.

I am somewhat in disagreement with this statement and feel that if such data upon which the appraisal is set forth in the report as representing an opinion other than that of the appraiser that an appraiser should be permitted to issue such a report. A situation such as this is not more than many hypothetical questions which are put to expert witnesses giving court testimony. What it amounts to is really "if this property will produce such an amount of money, how much will it be worth"? To answer such a question does not, in my opinion, constitute unethical practice.

It seems to me that these questions are somewhat in the nature of a proposal to establish a police power over the Members of the Institute. While this may be of value so far as the public is concerned, I believe that any action taken should be done through a special committee formed for this purpose. This committee, I believe, should act only when in its opinion sufficient evidence has been submitted to it by a Member of the Institute to make it desirable that another Member be examined. Disclosure of the Member making complaint should, of course, not be made and I believe that the Member questioned should have the right of appeal from any decision of this committee to the Governing Council of the Institute whose decision should be final.

Mark Levy.

Chicago, Jan., 1933.

Gitterman — **On Dishonest Appraisals**

OWING to the deplorable conditions now prevailing, which to a great extent are directly chargeable to the depression through which we have passed, I am convinced that other things besides the tariff have become "purely local issues," as Thomas Brackett Read once said.

Honesty, morals, and ethics have likewise become a local issue which in many instances are not even discussed by the man himself nor understood beyond his personal point of view.

Before discussing ethical procedure, it seems to be important to the practitioner to weigh who adopted the code and under what circumstances it was forced upon him.

I am quoting from a letter received on January 18th last, omitting from the same, however, the names:

"An old Connecticut Yankee, whom I recently met, bewailed shrewd, present-day methods. He criticized (name deleted) for what I call a clever bit of business.

"A manufacturer of a (name deleted) engine part was ordered to ship each unit in a packing case made of lumber of specified size, grade and thickness, fastened with a certain

number of screws placed in specified spots. The manufacturer obliged, but thought his customer unduly fearful of shipping hazards. A year later he learned the reason.

"When dis-assembled, the parts of each packing case were used as floor boards for a (name deleted), fitting perfectly, with screw holes already drilled. The manufacturer resented the strategy that supplied (name deleted) with floor boards for nothing."

Apparently from the above, one would judge, if the facts are as represented, that the automobile manufacturer was unethical in demanding a particular kind of lumber specification to be applied, when he was buying an automotive part, as his honesty would have prevented the manufacturer of automotive parts from squandering money on an unessential to the part he was selling.

The automobile manufacturer is decidedly *dishonest* when using second-hand lumber in a new car without direct representation that this was a fact, which proves that the Connecticut Yankee had a set of good morals and ethics that were high.

The writer of the letter in New York disagreed, while the automobile manufacturer in the west apparently lacked both the proper moral conception, honesty and ethical point of view.

In any discussion of ethical procedure, the code adopted must be recognized as having been drawn by humans for the regulation of fellow members.

The personal equation will always dominate, and what constitutes a dishonest appraisal must be judged entirely by the thought and action of the appraiser.

a. What constitutes a dishonest appraisal?

1. A deliberate misrepresentation of fact, figures or conditions.
2. A theory not susceptible of proof but used in an appraisal to "collect a fee."
3. An assumption of unit values without proper sustaining data.

b. How shall dishonest or wholly unwarranted opinions be dealt with?

1. The organization should disqualify any dishonest appraiser after hearing and applying the tests above referred to.

c. How shall we determine when an opinion or valuation is wholly unwarranted?

1. Determining the necessity of an opinion or a wholly unwarranted valuation is susceptible of various checks.

An appraiser whose ordinary work is the auctioning of property where he never receives a bid until after a suggested price has been made, subconsciously becomes pessimistic and reflects a conservative trend in his appraisals, while an appraiser actively engaged in brokerage in highly valued properties, for which there is a demand, subconsciously becomes optimistic and reflects this thought in his appraisal work.

The conservative and scientific work, however, would leave very little to the personal opinion of an appraiser if he were guided by actual sales and mortgages in a district, and follow the trends which have been established by a careful charting of these correlated figures over a period of years, comparing these with the charts of trends in commodities and other readily available statistical matter, including stock market ,bank clearances, car loadings, steel production, employment, money rates and business failures.

All appraisals, however, aside from the scientific application of known

information, cannot exclude the personal equation and the knowledge that has been acquired through long experience in actively buying, selling, leasing and mortgaging of property as a broker, agent and/or manager.

A. N. Gitterman, M. A. I.
New York City, January, 1933.

Smith — On Contingent Fees

A MEMBER of the American Institute of Real Estate Appraisers should not accept fees on a contingent basis for his professional services in tax appeal cases.

If a member of this profession is employed to present a tax appeal, his qualifications for accepting such employment will enable him readily to determine the legitimacy of such a claim and to what extent his principal is entitled to relief.

In his line of work he is a specialist, not only in his own opinion, but so recognized by his own craft. In the matter of payment for his work, a *per diem* basis is the only satisfactory method.

The proper and complete preparation of a tax appeal case is a full service rendered and, when used by a client in presentation to the taxing authorities, carries with it, the full force of the ability and standing in his profession of the man making such a report, and should be paid for, for full value received, on that basis.

This type of work places the appraiser on a different plane with the taxing authorities, as, when under oath, I have been asked, "Are you working on a *per diem* basis, as usual?" The reason for the question was that during the last two years we have had to compete with one or two men who were employed on a contingent basis and paid in advance. Their cases were poorly prepared and the taxing authorities employed me on a *per diem* basis to oppose the tax appeals for them.

If a member of the American Institute of Real Estate Appraisers has built up his business over a period of years on a *per diem* basis and has earned the confidence of his clients by efficient work and reasonable charges for his services, he does not have to seek employment on a contingent basis.

Lewis R. Smith, M. A. I.
Cincinnati, Ohio, January, 1933.

Allingham — On Contingent Fees

AT THE law, a practicing attorney may accept a case on a contingent basis; but he must not guarantee a result. A lawyer is in a much different position than an appraiser, because he must use every legal method to accomplish the result his client expects. An appraiser is defined in our Standards of Practice as "One who has the necessary analytical ability, experience, knowledge, and *judicial temperament* to make an appraisal," and in Article 1 of Section 11 he is expected "in his professional capacity" to be absolutely disinterested and have no pecuniary or "other interest in the property or the outcome of his appraisal." As an appraiser he is a judge of values. He must hold the scale so that he can give a balanced judgment. Otherwise he is a partisan.

The fairest method seems to be payment on a *per diem* basis regardless of results. If an appraiser is known to be fair and reasonable he gets a better hearing and his service is sought after. Taking a case on a contingent fee basis cannot help but color the judgment of the appraiser. He is not as free an agent as if his fee were based upon the service rendered without reference to result. If one be worthy of his hire his fee should not be based upon the success of his venture in the mind of another whose duty it is to hold the balance on him

and his cause—the judgment of the Court, for example.

The only thing an appraiser has to sell is his time, his ability to analyze real estate, his integrity, his reputation; and a contingent fee opens the way for attacks upon these. If these attacks succeed he soon loses the result of his years of character building. The busy appraisal expert has enough attacks made upon his judgment every day without having to defend himself because of his fees.

In this I assume an appraiser is correctly defined in our Standards of Practice and is not to be confused with one acting as agent for a property owner or his advocate in pleading for tax reduction. Real Estate appraiser and Real Estate agent are not synonymous terms.

A. P. Allingham, M. A. I.
Buffalo, N. Y., January, 1933.

Smith — On Contingent Fees for Expert Witnesses

A MEMBER of the American Institute of Real Estate Appraisers should not accept nor desire employment as an expert witness in any kind of a court case on a contingent fee. My reasons are as follows:

The majority of court cases are tried by lawyers who are employed on a contingent fee basis.

An expert witness is similar to a law book, in working up the case for his client's lawyer. It may take a short time thoroughly to prepare the case and it may take a long time, and, in my opinion, the fairest way to be compensated is on the *per diem* basis.

No man who has had experience in this kind of employment will deny that the most exhaustive study of the facts in the case must be made if the testimony of the witness is to be effective with a jury and no amount of time spent in preparing for the case is wasted.

In this way the expert has no financial interest in the verdict and can be more effective with the jury if his answer to the cross-examiner is that his employment is on a *per diem* basis for the actual time spent in court and in preparing to testify.

Too often the appraiser working under a contingent agreement, haunted by the possibility of an adverse verdict, and tempted by some more certain profitable work, will digress from the work of thorough preparation which may result in his client unjustly losing the case.

We are now building a new organization with which we hope to elevate and maintain the standards of a great profession. In my opinion, one of the best ways to perpetuate this Institution and maintain its high standards and ideals is to adopt, wherever possible, a standard rate for employment and by a united effort eliminate, as far as possible, the contingent fee competition.

Lewis R. Smith, M. A. I.
Cincinnati, Ohio, January, 1933.

Allingham — On Contingent Fees for Expert Witnesses

IT MUST be noted that in a controversial matter the appraiser is employed by one side or the other, and therefore has to contend against the assumption by the opposing side that his judgment is biased. If it should develop during the trial of the action that his fee depends upon the result, that will surely label him at once as a partisan.

A *per diem* basis or the basis of appraisal fees agreed upon by custom of the local Board for the service rendered without regard to the outcome cannot be criticized. An appraiser should make his charges in line with other professional services and not be tempted by contingent fees to give

unconsidered opinions. If the service is worth performing, it should be done well or not at all. The fee should be high enough to warrant a free expenditure of time in preparation and a full measure of supporting data.

A. P. Allingham, M. A. I.
Buffalo, N. Y., January, 1933.

Berry — On Contingent Fees for Expert Witnesses

I BELIEVE I have handled as many tax appeal cases in Essex County as any other man in the county. I have obtained this business largely because of my experience on the Newark Tax Board for a number of years.

In handling these cases I do not accept them as a Real Estate Broker or Appraiser, but as a Tax Expert. In many cases it is necessary for me to engage outside experts to qualify for the values of buildings; and I think I am in position to judge the question of ethics in tax situations as well as anyone else who is doing this type of business.

My personal reaction to this question is that it is not a matter for the Institute to consider.

First, because the question of value does not always enter into the testimony, it being rather a question of comparability with other assessments and the application of the law in the State in relation to these assessments. No expert would accept an assignment to appear before any local body to ask that adjoining property be raised, but would rather appeal upon the real value of the property of the owner whom he is representing as compared to the values placed by the City on adjoining properties, showing the difference in ratio to value.

A tax expert who is sincere and honest in his business will not attempt to reduce the value of a property merely to secure a tax reduction, as the testimony given in his tax case may be very embarrassing to him in some other appraisal work, were he to consider only the question of a reduction in taxes in order to make his fee.

There seems to be no objection by the Courts to lawyers taking a tax case or any other case on a contingent basis. In most of the cases where real estate men testify, they are paid on a *per diem* basis; but in cases where one holds himself out as a tax expert, the matter of compensation must be different than from the regular real estate testimony.

This is a very big question and I think it should be given considerable thought before the Institute goes on record.

My personal reaction to it is that the Institute should take no action at this time on this question and that before they do take action there should be a differentiation between the tax expert and the testimony of an appraiser.

It is the custom of the appraisers in New Jersey to charge a fee for making an appraisal and a *per diem* charge for appearance in Court.

I do not think any of the Members of Chapter No. 1 have ever based their fees in condemnation upon the amount of an award. In this particular phase of the case, I would say it would be unethical for any Member to testify as to the fair market value of a property under condemnation if he were interested in getting a fee based upon an award of the jury of commissioners.

John J. Berry, M. A. I.
Newark, N. J., January, 1933.

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Definition of Terms

Levy — On Value

IN my opinion the definition of value appearing upon page 3 of the Standards of Practice would be just as effective if not more so, if the words "competitively established price" were omitted and the words "amount in money" substituted for them. I feel that the definition as it now stands is somewhat in contradiction to itself because of the dissimilarity which might exist between any present competitively established price and the present worth of all rights to future benefits. These might be two figures quite at variance with each other.

Under existing economic conditions particularly, the item of competition is one which in my opinion is practically *nil*. Were the definition in the Standards of Practice to govern the issuance of all appraisals of investment properties, we would be confined in our value estimates to the price which might be obtained in the present market so far as that part of the definition referring to competitively established price is concerned. At the present time such a value would undoubtedly be established by a very definite lack of competition. However, an appraiser giving consideration to future benefits arising from ownership might find himself estimating a value much greater at the present time than that which might be obtained by considering only so-called competitively established prices.

The price at which a property may sell in the market need not necessarily reflect the true value of that property. We should by now realize that the selling prices of four to six years ago were not reflections of true value and we should similarly realize that the prices at which properties may be bought in the present market are also not reflections of true value.

It has always been my contention that the term "market value" has an entirely different meaning than any of the terms which are intended to convey the idea of sound value, true value, stabilized value, fair cash value, etc. Market value to me means nothing more nor less than the price at which a property might sell within a reasonably short period from a given date, taking into consideration various items such as competition or lack thereof, activity of the market or lack thereof, etc. In a particularly active market, as the result of high pressure salesmanship, properties may sell at prices far beyond their true value. Other circumstances may also exist which might cause the purchase of properties at prices greater than their true values. Such circumstances may include a special need for a particular property, the necessity for acquisition to complete consolidation, etc.

I am also taking the liberty at this time to express myself to the effect that many court decisions tend toward the opinion that sales prices represent the sole criterion of value. I do not believe that such confinement to the appraiser is judicious, as many items other than the selling price of a parcel of real estate should and must be given thorough consideration and analysis before the true value of the property may be obtained. I feel that the true value of a property may be and quite often is considerably at variance with its market value at a given date.

It is my opinion that the definition of value in the Standards of Practice need not particularly concern itself with competitively established prices and I do not feel that the definition of

value needs to include the word "market". If the word "market" is included, then I do not believe we need go further than the phrase "competitively established price".

I believe that the definition might well read as follows: "The value of a property at a designated date is that amount in money which represents the then present worth of all the rights to future benefits arising from ownership."

(U. S. Supreme Court Chief Justice Brewer. C. C. C. & St. L. R. R. vs. Victor M. Bockus, May 26, 1894—154 U. S. 445: "The value of property results from the use to which it is put and varies with the profitableness of that use present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use.")

I have evolved a definition of fair market value which may be of interest to you because it is applicable I believe to all classes of property, whether it be vacant land, land improved with residential or commercial structures, leasehold estates, or any other class:—

"Fair market value is the price at which a willing seller and a willing buyer would agree to trade if both were aware of all relevant facts.

"In other words, this definition postulates the existence of a willing seller and a willing and able buyer, both familiar with the existing conditions and with all elements and factors of value; both reasonable in their views, acting for their own best interests, and each willing to make such adjustments in his views upon value as might be necessary to bring about a sale at a reasonable amount, fair to both parties."

That portion of the Standards of Practice which pertains to the "balancing of appraisal" appears to be nothing more or less than an opening for the appraiser to modify a so-called tentative value to meet some preconceived opinion which he may have had concerning the value before he made his computations. If the property is an investment property producing or capable of producing annual net returns and a forecast has been made of the net earnings over the remaining economic life of the improvements then there need be no balancing of the appraisal. If this balancing method is used as a means to an end, it has in it the possibility of destroying the foundation of the value, this being the forecast of net earnings.

For example—if a property under appraisement is considered by the appraiser as being not improved to its highest and best use and the building is made residual, producing by this process a building value considerably lower than the cost of reproduction less depreciation, then the balancing processes as described in the Standards of Practice might produce a total value for the property far in excess of that justified by the forecast of net earnings to the end of the economic life of the improvements.

The last paragraph of this section might well be the basis for the entire section and with some elaboration and explanation of this last paragraph, I believe that the balance of this section might be eliminated so far as Investment Properties are concerned.

Mark Levy, M. A. I.
Chicago, Jan., 1933.

Kissack — On Value and Price

PRICE is the amount specified for the sale or exchange of a property expressed in dollars. The dollar (in the United States) is merely the measure of price. It is possible to exchange one property for another without expressing the measure of each in dollars; in such cases the price of one property is the other property.

Price always indicates the property is for sale. A property could have con-

siderable worth and a high value placed upon it but if it were not for sale, it would have no price. Many qualifying prefixes are used to indicate the kind of price when the property is offered for sale or actually sold; some of these are cost price, sacrifice price, distress price, fair price, inflated price, etc. In the sale of a property there is the asking price of the seller, the offering price of the buyer, and the sale price of seller and buyer when these two are in agreement.

Worth is an inherent quality of a property which depends upon its utility and its scarcity or abundance. Each property has its own distinctive worth which differs from the worth of every other property. Many factors influence the worth of a property, such as:

1. **Location:** Availability of and accessibility to transportation, school, church, and other facilities.
2. **Neighborhood:** Types of surrounding properties; types, nationality, race, and standard of living of neighborhood population.
3. **Actual use:** Kind of use, size, design, efficiency of use, age, condition, depreciation and obsolescence, remaining life expectancy, and Management.
4. **Restriction of use:** Zoning ordinances and deed restrictions limiting property to specific uses—easements, etc.
5. **Tenancy:** Type of tenancy, length and security of leases.
6. **Potential use:** Expected higher use of the land. Trends and shifts of population.
7. **Supply and Demand:** Surplus of comparable properties, rates of acquisition and absorption.
8. **Benefits:** All other rights and benefits arising from the property.

Worth is not expressed in dollars; it springs from the property itself. Only a complete analysis of all of these factors can determine the real utility and the relative scarcity of a particular property. A property without utility, like the well-known office building in the desert, or with unlimited supply like the air, has no worth. Before appraising or fixing the value of a property, its worth must be determined.

Value is the opinion, estimate, or appraisal of the worth of a property expressed in dollars. No property possesses value in itself. Value is placed upon it by some person or persons. "A" and "B" may have entirely different opinions as to the worth of a property and each arrive at a different value for it. The more accurate the various items of worth of a property are collected, classified, and analyzed and the more exact and logical are the procedure and technique used in forming a judgment, the more proper and sounder will be the determined value.

Major A. B. Kissack.

St. Louis, Mo., Jan., 1933.

Rogers — On Value and Price

THERE is no question that considerable misunderstanding exists between one person and another due to their individual interpretation of *value* as used in appraisal work. In order to facilitate business, some index of the comparative commercial merit of real estate was and is necessary.

The word *value* came into use; but this word's meaning is elusive in nature unless exactly qualified, being subject to wide interpretation, and having definitions which vary to a considerable extent. It would be helpful to those who have occasion to use appraisal reports and are not familiar with the technicalities involved if some phrase could be devised to identify the *value* indicated without lengthy explanation. The two most widely accepted definitions are as follows:

1. *Value — "Fair cash market value is an expression, in money, of the meeting of the minds of the buyer willing but*

not compelled to buy and the seller willing but not compelled to sell."

This definition is generally accepted, mainly by the legal profession, as a true definition of *value*. The amount expressed here is mainly of a current nature, no particular emphasis placed on trends, and comes a great deal closer to defining the Fair Market Price.

2. *Value—"The present worth of all rights to future benefits arising from ownership."*

This amount would undoubtedly be the *value* if the future benefits could be closely estimated. Unfortunately, such is not the case. It would be quite possible and fairly accurate to make an estimate of *value* under this definition if it were made on a retrospective basis, say as of some date twenty years ago. Knowing all of the intervening history, events, and factors which have affected the property, the benefits could be measured and reduced to a worth as of that prior date and the value closely estimated.

All that is humanly possible under this definition is to make a study of factors and trends and make such assumptions and hypotheses as are consistent with reason, estimate the future benefits and reduce them to an expression of present worth. That the resultant amount is derived by theoretical procedure is apparent, and that errors will be proved through the lapse of time is also apparent. Nevertheless, no sound judgment can be exercised unless consideration is given to future trends.

It is evident that the number or index wanted called *value* takes into consideration both of these angles,—current prices where property is exchanged in a free market and more or less justified amounts wherein changes in value levels are anticipated. There is considerable doubt in my mind that the use of *value* as an expression and without qualification combined with dollars to identify the comparative commercial merits of real estate parcels is advisable. It has, by usage, come to mean continuity; it is forceful and lends emphasis to a number which is an estimate.

There is no doubt that the number required should express the relative degree of merit, in dollars, from a commercial exchange basis in which both market conditions and future expectancy should be taken into account.

In casting about for a phrase which, while expressing the same amount, qualifies the word *value* with its ambiguous definitions and dangerous intimation of continuity by those who would use it inadvisably, we come to the following:

Price is merely a handle to a number expressing dollars; it can be either high or low, high today, low tomorrow, strictly a current proposition, and generally understood as such.

"Price" is insufficient, however; and, if qualified with *market*—thus, *market price*—takes on more meaning, introducing the idea of universal exchange rather than individual exchange. It remains, however, a current proposition largely disregarding trends.

"Market Price" is insufficient, so the word *justified* is added—thus, *justified market price*—introducing the idea that consideration has also been given to future trends and that judgment

has been exercised in this qualification.

To be complete and accurate, the word *estimated* is prefixed to denote the term is an estimate—thus, *estimated justified market price*—and this amount is the index required for the purpose we have in mind. At the same time, we have not stated that it is the *value*, with all the diversified meanings the word has come to mean, implied.

If the phrase is used as follows—*value* (*estimated justified market price*)—it should more accurately give those who have reason to use appraisal reports a more definite opinion of the number expressed.

To Appraisers, such a term would mean no less effort accurately to guage the same, yet it would lessen the apprehension felt due to lack of uniform interpretation of *value* and it would also lessen the degree of hardness when circumstances required a change in the number illustrated.

To others who refer to appraisal reports, it should put them on their guard that the number given is subject to change, that it means just what it says, nothing more, nothing less—*value* (*estimated justified market price*).

The absence of such a term has resulted in misunderstandings to the point where practically no informed person will seriously accept a *valuation* unless considerable knowledge of the person who estimates the *value* is known.

It would be more reserved and more truthful for Appraisers to furnish estimates of *justified market prices* rather than *values* in view of the foregoing. Since this is what we have been attempting to give for some time and called them *values*, it appears advisable to qualify *value* as indicated, as it will reduce misunderstanding.

Whether or not this phrase is satisfactory and sufficient is unknown, but we merely make this suggestion for such consideration as it may deserve.

F. E. Rogers.

Chicago, Illinois, Feb. 15, 1933.

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Standard By-Laws for Local Chapters

Article I. Objects

SECTION 1. The objects of the Chapter shall be:

a) The advancement of the science of appraising and evaluating interests in real property;

b) The fostering of knowledge, of integrity, and the fair and accurate judgment of value of real property;

c) The professional advancement of its members;

d) The promotion of technical and scientific discussion among its members;

e) The promotion and propagation of sound, proper, and ethical practices;

f) To promote adherence to the Standards of Practice and Code of Ethics of the American Institute of Real Estate Appraisers.

Article II. Membership

SECTION 1. Membership in the Chapter shall be divided into the same grades and shall, in general, carry the same respective privileges as membership in the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards.

SECTION 2. Membership in the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards shall be the sole qualification for membership in the respective corresponding grades in the Chapter.

SECTION 3. No individual may be retained as a member of the Chapter, if for any reason his membership in the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards is terminated.

Article III. Dues

SECTION 1. Subsequent to their election, Members shall not be entitled to a Membership-Identification Card or any other benefits until the initiation fee, if any, and dues for at least twelve months have been received by the Chapter. Failure to make such payments within ninety days of notice of election shall void the election to membership.

SECTION 2. All dues become payable on January 1st of each year and in case of memberships accepted subsequent to that date, dues for the second year will be adjusted on a quarterly pro-ration.

SECTION 3. Annual membership dues of Members shall be $....................

SECTION 4. Annual membership dues of Affiliates shall be $....................

Article IV. Identification Card

SECTION 1. Each Member shall receive annually from the Treasurer of the Chapter an Identification Card, which shall serve as receipt for dues for the current fiscal period.

SECTION 2. Membership identification cards shall be promptly returned to the Secretary of the Chapter when the membership of the individual to whom it is issued shall for any reason be terminated.

SECTION 3. Affiliates shall receive proper acknowledgment upon receipt of dues.

SECTION 4. Each application for admission shall be accompanied by one year's dues for the grade to which the candidate seeks admission. Should the application be rejected, this deposit shall be refunded.

Article V. Nomenclature

SECTION 1. All Members of the Chapter may identify themselves by the words "Member Chapter No. .... American Institute of Real Estate Appraisers," on office signs, letterheads, business cards and any other professional forms providing the same shall be dignified and satisfactory to the Executive Council and in accordance with the rulings of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards.

SECTION 2. Affiliates shall not be permitted professional identification with the Chapter.

Article VI. Executive Council

SECTION 1. The governing power of the Chapter shall be vested in an Executive Council, consisting of the President, Vice President, Secretary, and Treasurer, together with such Members of the Governing Council of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards who shall be Members of this Chapter, and in addition thereto the chairman of standing committees who shall be appointed by the President of the Executive Council.

SECTION 2. The President, Vice President, Secretary, and Treasurer of the Chapter shall also be respectively the President, Vice President, Secretary, and Treasurer of the Executive Council and shall be elected at each annual meeting to serve for one year. Their duties shall be such as pertain to their respective offices. The President of the Executive Council shall have the power to appoint the chairmen of all standing committees, by and with the advice and consent of the Executive Council.

Article VII. Nominating Committee

SECTION 1. The Nominating Committee shall consist of five Members who shall be elected by ballot at the meeting preceding the annual meeting at which the election of officers shall take place.

SECTION 2. It shall be the duty of the Nominating Committee to nominate at least one Member for each office; these nominations shall then be reported to all members of the Chapter at least two weeks prior to the annual meeting. Additional nominations may be made by petition signed by at least three Members in good standing, providing such nominations shall be in the hands of the Secretary of the Chapter at least five days prior to the annual meeting. The report of the Nominating Committee and any additional petitions for nomination shall be presented at the annual meeting at which the elections are to take place.

Article VIII. Meetings and Quorums

SECTION 1. The annual meeting of the Chapter shall be held within one month following the annual meeting of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards.

SECTION 2. Other meetings may be called by the Executive Council from time to time.

SECTION 3. All meetings shall be open to all Members and all Affiliates. Affiliates shall be entitled to the privilege of the floor; but only Members shall vote or hold office or serve on Committees.

SECTION 4. Fifty per cent (50%) of the Members of the Chapter shall constitute a quorum at any meeting, provided that they must be present in person and in good standing, and that at least one week's notice of the meeting shall have been given by the Secretary.

SECTION 5. All members are to be notified by mail, sent out at least one week prior to the date of any meeting, of any decisions to be made at that meeting. Any decisions made without such prior notice shall not be final until confirmed at a subsequent meeting following due notice of the action to be considered.

Article IX. Standing Committees

SECTION 1. The standing committees shall include a Membership Committee and a Committee on Standards of Practice and Ethics.

SECTION 2. Each of the standing committees shall consist of three or more Members of the Chapter and shall be annually appointed by the President of the Executuve Council.

SECTION 3. The duties of these Committees shall be specifically defined by the Instructions which they shall receive from time to time from the Executive Council.

SECTION 4. By and with the advice and consent of the Executive Council, the President shall appoint such special committees as from time to time should prove necessary. The duties of these special committees shall be specifically defined.

Article X. Amendments

SECTION 1. These By-Laws may be amended at any meeting by a two-thirds vote of all the Members in good standing, providing ten days' notice shall have been given together with a copy of the proposed amendment, and provided further that such amendments are approved by the Governing Council of the American Institute of Real Estate Appraisers of the National Association of Real Estate Boards.

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Digest of the Proceedings of the Annual Meeting

Tuesday, January 24, 1933

The Governing Council convened in the New Willard Hotel, Washington, D. C., at 2:00 P. M., with President Philip W. Kniskern of New York City, presiding.

Minutes of the preceding meeting were read and approved.

The following membership and financial report was read and approved:

1. Number of Members as of December 31, 1932 168
2. Number of Affiliates as of December 31, 1932 237
3. Number of Non-member subscribers to "The Journal" 68

Balance, January 1, 1932	$1,492.79
Income, January 1—December 31, 1933	8,090.92
Total	$9,583.71
Expenditures in 1932	6,617.58
Balance, December 31, 1932	2,966.13

E. L. Ostendorf of Cleveland, Ohio, reported for the Committee on By-Laws, stating that no changes or additions were being considered at the present time. The report of the Committee was approved.

Walter S. Schmidt of Cincinnati, Ohio, and Herbert U. Nelson of Chicago, appeared before the Governing Council and asked for an

expression of opinion as to certain phases of the proposed tax program of the National Association of Real Estate Boards.

Mark Levy and Harry Grant Atkinson of Chicago, made verbal reports for the Publications Committee stressing particularly the desirability of securing additional non-member subscribers and some acceptable advertising at an early date. The report of the Committee was approved.

Joseph B. Hall of Cincinnati, Ohio, reported for the Committee on Appraisal Procedure. The Governing Council directed that the report be accepted, mimeographed, and mailed to all Members of the Institute.

Ralph D. Baker of Camden, New Jersey, reported for the Committee on Ethics. The Governing Council directed that the report be accepted, mimeographed, and mailed to all Members of the Institute.

The Governing Council ruled that the membership certificate of Members shall not be reproduced for advertising or any other purposes.

The Governing Council directed that a letter be sent to all Members suggesting, but not requiring, that copies of letterheads, business cards, or other advertising material carrying reference to membership in the Institute, be submitted to the Ethics Committee for approval before being printed.

J. Alvin Register of Jacksonville, Florida, reported for the Committee on Local Chapters, recommending:

1. That the By-Laws of New Jersey Chapter 1 be approved as submitted.

2. That the By-Laws of Florida Chapter 2 be approved as submitted.

3. That a Charter for a local Chapter be granted to Members of the Institute doing business in the State of Ohio, jurisdiction co-extensive with the political boundaries of the State of Ohio.

4. That a Charter for a local Chapter be granted to Members of the Institute doing business in the Metropolitan district of New York City, jurisdiction co-extensive with the political boundaries of the Boroughs of Bronx, Queens, Brooklyn, Manhattan, and Richmond, and the Counties of Westchester, Nassau, Suffolk, and Kings.

5. That a Charter for a local Chapter be granted to Members of the Institute doing business in the State of California, jurisdiction co-extensive with the political boundaries of the State of California.

6. That no Charter be granted to Affiliate members of the Honolulu Realty Board.

The recommendations of the Committee on Local Chapters were unanimously approved and Charters granted for the founding of local chapters in Ohio, Metropolitan New York City, and the State of California, with reservation of the right to divide the respective jurisdictions of these Chapters and found additional Chapters whenever such action may, in the judgment of the Governing Council, be desirable.

Bracton Goldstone of New York City, reported for the Membership Committee. The report of the Committee was unanimously approved.

The Governing Council ruled that all Members of the Realtor Secretaries Division be put on the mailing list to receive complimentary subscriptions to **The Journal of the American Institute of Real Estate Appraisers** for a period of one year.

The Governing Council authorized President Kniskern to appoint a Nomination Committee for the year 1933.

There being no further business, the Council adjourned at 5:00 P. M.

Wednesday, January 25, 1933

The Institute convened in the New Willard Hotel, Washington, D. C., at 9:30 A. M., with President Philip W. Kniskern of New York City, presiding.

Max Tieger of Elizabeth, New Jersey, spoke on "The Appraisal of a Two-Story Business Building — 100% Location."

George H. Gray of Brooklyn, New York, read a paper prepared by Ivan A. Thorson of Los Angeles, California, commenting on the Capitalization Rate Used in Mr. Tieger's appraisal.

Mr. Willis of Boston, Massachusetts, read a paper prepared by George L. Schmutz of Los Angeles, California, also commenting on the Capitalization Rate Used in this appraisal.

Mr. Cuthbert E. Reeves of Buffalo, New York, presented a manuscript contributing to the discussion, as did also Mr. Bracton Goldstone and President Kniskern of New York City.

The following contributed to the discussion on "The Prophetic Analysis of Future Benefits" in connection with Mr. Tieger's appraisal report: William H. Ballard of Boston, Massachusetts; Frank D. Hall, New York City (through a paper read by Joseph B. Hall of Cincinnati, Ohio); Carlton Schultz of Cleve-

land, Ohio; Walter R. Kuehnle of Chicago; and Cyril R. DeMara, Hamilton, Ontario, Canada.

The following contributed to the discussion on "Should the Land Value Be Made Residual to the Improvement or the Improvement Residual to the Land" in connection with Mr. Tieger's report: George H. Gray, Brooklyn, New York; Morris Goldfarb, Perth Amboy, New Jersey; Cyril R. DeMara, Hamilton, Ontario, Canada; Philip W. Kniskern, New York City; Carlton Schultz, Cleveland, Ohio; Burton Thompson, Elizabeth, New Jersey; Bracton Goldstone, New York City; A. C. Houghton, Washington, D. C.; and Cuthbert E. Reeves, Buffalo, New York.

The following contributed to a discussion on "How Should the Value of Vacant Land Be Determined Today": Walter S. Schmidt, Cincinnati, Ohio; and Walter R. Kuehnle, Chicago, Illinois.

The following contributed to a discussion on the topic "Should a Member of the Institute Who Represents Clients in Matters of Tax Appeals Accept Fees on a Contingent Basis?": Ralph D. Baker, Camden, New Jersey; Lewis R. Smith, Cincinnati, Ohio; A. P. Allingham, Buffalo, New York (through a paper read by Maurice F. Reidy of Worcester, Massachusetts); and Harry E. Gilbert, Baltimore, Maryland.

The following contributed to a discussion on the topics "What Constitutes a Dishonest Appraisal"; "How Should Dishonest or Wholly Unwarranted Opinions Be Dealt With"; and "How Shall We Determine When an Opinion or Valuation is Wholly Unwarranted": Mark Levy, Chicago, Illinois; and A. N. Gitterman of New York City (through a paper read by Philip W. Kniskern of New York City).

The following contributed to a discussion on "How to Use the Term M. A. I. in Appraisal Reports and on Letterheads when the Individual Member is a Member of a Firm"; and "The Use of the Institute Emblem": Percival V. Bowen, Buffalo, New York (through a paper read by Bracton Goldstone of New York City); George H. Gray, Brooklyn, New York; and E. L. Ostendorf, Cleveland, Ohio.

Joseph B. Hall of Cincinnati, Ohio, led a discussion on "Questions of Standards of Practice."

The following contributed to a discussion on "Definition of Value": Mark Levy, Chicago, Illinois; and Delbert S. Wenzlick, St. Louis, Missouri.

There being no further business to come before the Institute, the meeting adjourned at 5:15 P. M.

Friday, January 27, 1933

The Governing Council convened at the New Willard Hotel, Washington, D. C., with President Philip W. Kniskern, New York City, presiding.

Frank H. Taylor, East Orange, New Jersey, reported for the Admissions Committee, recommending that the following candidates be elected to the grade of Member:

George Baur, Brooklyn, N. Y.
Hal Forrester Coombs, Providence, R. I.
Irving I. Rosenbaum, New York City, N. Y.
Morton J. Luchs, Washington, D. C.
Frank B. Fay, Jr., Butler, N. J.
A. K. Hornof, Chicago, Ill.
George L. Atkins, Trenton, N. J.
D. E. C. Somers, Jersey City, N. J.
P. Lincoln Mitchell, Cincinnati, Ohio.
James J. Grogan, Cincinnati, Ohio.
Howard R. Burgess, Cincinnati, Ohio.
Philip N. Arnold, Philadelphia, Pa.

Mr. Taylor reported that action had been deferred on several applications, and that Arnold DeWolf Arnold of Elizabeth, New Jersey, had withdrawn his application.

The report of the Admissions Committee was unanimously approved and the candidates recommended for admission to the grade of Member were duly elected.

Friday, January 27, 1933

The Institute convened in the New Willard Hotel, Washington, D. C., at 9:00 A. M., with President Philip W. Kniskern, New York City, presiding.

Captain Henry Wolfson, Vice President in charge of Real Estate, F. & W. Grand-Silver Stores, Inc., New York City, delivered an address on "Percentage Leases."

Francis K. Stevens, Vice President of Brown, Wheelock, Harris & Company, Inc., New York City, delivered an address on "What Are the Appraiser's Duties Today as to Values."

Harry G. C. Williams, President of the Philadelphia Real Estate Board, Philadelphia, Pennsylvania, delivered an address on "Building for the Ages."

The following contributed to a discussion on "The Influence of Taxes Upon Real Estate Values": J. W. Graham, Nashville, Tennessee; Arthur S. Kirk, Des Moines, Iowa; W. S. Guilford, Sacramento, California (through a paper read by one of the members present; and Edward M. Ashton, Salt Lake City, Utah (through a paper read by Dr. Arthur J. Mertzke of Washington, D. C.).

There being no further business to come before the Institute, the meeting adjourned at 5:00 P. M.

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New Members

At the Regular Quarterly Meeting of the Governing Council, held in Washington, D. C. on January 27, 1933, the following were elected to the grade of Member in the American Institute of Real Estate Appraisers:

Morton J. Luchs, Washington, D. C.

Born in Washington, D. C.; Vice-President and Treasurer, Shannon & Luchs Company; Vice-President and Treasurer, Shannon & Luchs Development Company; Director, Real Estate Title Insurance Company; Active member, Washington Real Estate Board; member, Washington Board of Trade; member, Washington Chamber of Commerce; lecturer on real estate subjects in the Washington Y.M.C.A. school; real estate experience covers a period of 31 years.

J. C. Stewart, Orlando, Florida

Active member, Orlando, Florida Realty Board; Florida representative, Thorpe Brothers, Minneapolis, Minn.; agent, Moe-Bridges Company, Milwaukee; agent, Mobricon Company, Milwaukee; representative, John V. C. Hegeman, Glen Head, L. I., N. Y.; twelve years experience in the general real estate business.

A. K. Hornof, Chicago, Illinois

Born in Chicago, Ill.; Vice President, Harry S. Cutmore and Associates, Inc.; formerly with the American Appraisal Company; formerly with Ford, Bacon & Davis, Inc.; recently manager of the New York and Chicago offices of the Manufacturers Appraisal Company; active member, Chicago Real Estate Board.

Frank B. Fay, Jr., Butler, N. J.

Born in Philadelphia, Penn.; Active member and past President, Morris County Real Estate Board; 5 years on executive committee, New Jersey Association of Real Estate Boards; Treasurer, New Jersey Assn. of Real Estate Boards; appraiser for North Jersey District Water Supply Commission, the Federal Water Company, the Jersey Central Railroad Company, and the Ledgerwood Company; President, Fayson Lake, Inc.; Director and appraiser, Pompton Title & Mortgage Co.; appraiser, New Jersey State Highway Commission; appraiser, Passaic Valley Water Commission; former appraiser and estimator for the City Mortgage Company of Newark.

D. E. C. Somers, Jersey City, N. J.

Born in Jersey City, N. J.; Active member and President, Jersey City Real Estate Board; President, Veterans Building and Loan Assn. of Jersey City; 15 years real estate experience of which past 7 years have been devoted primarily to appraisal work.

George L. Atkins, Trenton, N. J.

Born in Asbury Park, N. J.; Active member, Trenton Real Estate Board; Vice-President and Treasurer, Colonial Land Company; Secretary and Treasurer, Westover Corporation; President, Trent Building and Loan Association; member, Executive Committee, Trenton Mortgage & Title Guaranty Company; Chairman, States Council of the National Association of Real Estate Boards; member, Board of Directors, National Association of Real Estate Boards.

George Baur, Brooklyn, New York

Born in Brooklyn, N. Y.; Associate member, Brooklyn Real Estate Board; makes independent appraisals for realty companies and individuals; President, Kings Post Realty Co., Inc.; Secretary, Forbro Realty Co., Inc.; from 1920-30 in charge of Appraisal Department, U. S. Mortgage and Trust Company, New York City.

Irving I. Rosenbaum, New York, N. Y.

Born in New York City; Vice President, Schulte Retail Stores Corp.; Vice-President Schulte Real Estate Company, Inc.; appraiser for the City of New York; Associate member, Long Island Real Estate Board; active in real estate business for over twenty years; has purchased and sold over $100,000,000.00 worth of realty.

Howard R. Burgess, Cincinnati, Ohio

Born in Cincinnati, Ohio; Class "B" member, Cincinnati Real Estate Board; Secretary-Treasurer, The Burgess, Droege & Spilker Company; specializes in business and industrial property in Cincinnati.

James J. Grogan, Cincinnati, Ohio

Born in Cincinnati, Ohio; Vice-President, The Fred'k. A. Schmidt Company; Assistant-Secretary, The Leibold-Farrell Building Company; Secretary, The Ingalls

Building Company; Secretary, The Cincinnati Land Shares Company; Secretary, Quality Homes, Inc.; Treasurer, Bell Building Company; Secretary, The Leelanau Realty Company; Secretary, The Southwestern Ohio Realty Company; Secretary, The Thos. B. Punshon Engineering Company; Asst. Secretary-Treasurer, George L. Rack, Inc.; Secretary, John Bunker, Inc.; class "B" member, Cincinnati Real Estate Board; past President, Cincinnati Real Estate Board; served on Committee of three which appraised all of the land in Hamilton County in 1931 for tax purposes; in business continuously since December 1, 1908 with Fred'k. A. Schmidt Company.

P. Lincoln Mitchell, Cincinnati, Ohio

Born in Newport, Kentucky; Vice-President, The Fred'k. A. Schmidt Company; Officer and Director in, The Cincinnati Land Shares Company, The Ingalls Building Company, The Thomas B. Punshon Engineering Company, The Leibold-Farrell Building Company; President, The Robert Mitchell Mfg. Co.; Director, The Cincinnati Ice Mfg. & Cold Storage Co.; Treasurer, The Cincinnati Music Hall Association; class "B" member, Cincinnati Real Estate Board.

Philip N. Arnold, Philadelphia, Pa.

Born in Bridgeton, N. J.; Active member and past President, Philadelphia Real Estate Board; President, National Realty Valuation Corporation; Vice President, Preferred Mortgage Guaranty Company; member Advisory Committee, Philadelphia Real Estate Board; Chairman Finance Committee, Pennsylvania Real Estate Association; past Chairman, Appraisal Committee, Philadelphia Real Estate Board.

Hal Forrester Coombs, Providence, R.I.

Born in Cherokee, Ia.; Affiliate member, Providence Real Estate Exchange; consulting engineer, Washburn Wire Co. of Delaware; member, American Association of Engineers.

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Current Articles

Actual Appraisal Reports. NATIONAL REALTY VALUATION CORPORATION. N. R. E. J. February, 1933, p. 46. $1.20. Valuation of Philadelphia hotel and apartment property for purposes of securing tax reduction.

Actual Appraisal Reports: Industrial Property. P. C. LOEBER, N. R. E. J. November 1932, p. 47. $1.20. Mr. Loeber is a well known Chicago Realtor and former vice-president of the National Association.

Application of the Square Foot Measure to Apartment Rents. A. B. KISSACK. B. O. & B. November 1932, p. 13. $0.45. Mr. Kissack is associated with the Real Estate Analysts, Inc. of St. Louis which is specializing in realty economics.

Appraisal of a Gas Station Site. D. D. SAYER, JR. N. R. E. J. January, 1933, p. 49. $1.20. An address before the recent Del Monte Convention of the California Real Estate Association.

Appraising Industrial Property. L. B. BEARDSLEE. M. R. February, 1933, p. 56. $0.70. Written by the new Chairman of the Industrial Property Division of the National Association.

The Capitalization Rate of Income Property Appraisals. A. J. MERTZKE. R. & B. G. January 7, 1933, p.3. $0.70. Dr. Mertzke, a former member of the staff of the National Association of Real Estate Boards, is now Economist for the Federal Home Loan Bank Board, Washington, D. C.

Changing Land and Building Values in the Chicago Wholesale District. J. E. BURTON. S. M. January, 1933, p. 10. $0.45. Mr. Burton is on the staff of The Institute for Economic Research, Northwestern University.

Current Operating Costs With Reduced Income — Apartment Houses. C. K. KERBY. B. O. & M. August, 1932, p. 13. $0.45. The author has devoted the major part of his time for the past eight years in the appraising of commercial properties.

Current Operating Costs with Reduced Income — Office Buildings. C. K. KERBY. B. O. & M. September 1932, p. 13. $0.45. Number two in a series of articles by a well known appraiser.

The Economic Importance of Competent Appraisals. H. S. CUTMORE. E. February 24, 1933, p. 5. $0.30. Mr. Cutmore is Chief Deputy Assessor of Cook County.

The Economics of Building Management. W. J. LAWLOR. B. O. & M. July 1932, p. 15. $0.45. Building management has a very definite connection with the older departments of our industry, such as brokerage, selling, appraising and owning. Unfortunately, a number of brokers and even some appraisers, have not kept abreast of the development of the management functions.

Land Values That Pay Profits. E. H. KLABER. R. E. January 7, 1933, p. 16. $0.30. Mr. Klaber says "Over-valuation of land has stagnated the market. Lower pricing will quicken realty activity and make logical profits possible for the developer."

Liberalizing Appraisals to Remove Pressure on Mortgages. P. A. STONE. R. & B. G. November 26, 1932, p. 5. $0.70. Efforts of the Consulting Committee on Real Estate and Mortgages to the Reconstruction Finance Corporation in the Second Federal Reserve District.

A New Generation of Land Values. W. R. KUEHNLE. R. E. February 25, 1933, p. 9. $0.30. R. E. March 4, 1933, p. 13. $0.30. In these articles Mr. Kuehnle ties together the current situation in the country with land values.

1931 Apartment House Experience Exchange Report. D. S. WENZLICK. S. M. January 1933, p. 21. $0.45. 47 apartment buildings submitted 1931 statements covering the operation of 1,980 apartments.

Obsolescence Insurance For Buildings. J. C. KNAPP. B. O. & M. November 1932, p. 24. $0.45. Such insurance is already in use in Europe and a $250,000 policy has just been written in Chicago on a printing plant.

Realty and Business Cycles. JULIUS KLEIN. B. I. November 1932, p. 30. $0.70. An address by the Assistant Secretary of Commerce, before the North Philadelphia Realty Board at Philadelphia, Pa. November 12, 1932.

Reminders For May First. L. T. CLARK. B. I. April, 1932, p. 28. $0.70. An analysis of the rental rates of office buildings.

Rent Money No Match for Costs. ARTHUR KRUGGEL. R. E. February 4, 1933, p. 15. $0.30. Comparative figures on seven properties, covering the years 1931 and 1932.

This Thing Called "Value". R. E. THOMPSON. N. R. E. J. December 1932, p. 29. $0.70. Mr. Thompson is an appraiser of recognized standing and ability and the author of several articles. He presents here several new concepts of value and takes issue with certain practices that have been common in the past.

Trends Affecting Urban Real Estate Values. H. A. BABCOCK. E. December 16, 1932, p. 5. $0.30. Why the conversion of land from a lower to a higher use and the dispersion of buildings or types of occupancy within any given area of a city determine the trends which affect city real estate values.

What Does It Cost to Operate Apartment Buildings? N. R. E. J. January 1933, p. 32. $1.20. Analysis of income and expense figures on 36 buildings, 2 to 45 flats, walk-up, unfurnished, housekeeping.

What Does It Cost to Operate Multi-story Apartments? N. R. E. J. February 1933, p. 50. $1.20. Operating experience of 8 multi-story, unfurnished buildings analyzed.

Winning Appraisal Report in California Annual Contest at State Convention, October 1932. C. R. E. M. November 1932, p. 27. $0.45. C. R. E. M. December 1932, p. 25. $0.45. Appraisal report on an eight-unit furnished apartment building by the Pasadena Realty Board.

The full names of the magazines indicated by initials on these pages are given below:

B. O. & M.	Building Owner and Manager	Monthly
B. I.	Building Investment	Monthly
C. R. E. M.	California Real Estate Magazine	Monthly
E.	The Economist	Weekly
M. R.	Manufacturers Record	Monthly
N. R. E. J.	National Real Estate Journal	Monthly
R. & B. G.	Real Estate Record and Builders Guide	Weekly
R. E.	Real Estate	Weekly
S. M.	Skyscraper Management	Monthly

Copies of the magazines in which these articles appear may be secured from the Library of the National Association of Real Estate Boards, 59 East Van Buren St., Chicago, Ill. The price listed includes the price of the magazine and a small service charge for mailing and postage. Subscriptions may also be placed with the National Association.

Book Reviews

Kniskern, Philip W. REAL ESTATE APPRAISAL AND VALUATION. New York: The Ronald Press, 1933. 532 p. $6.00.

THE advance made the past few years in the science, or perhaps we should say the business of appraising real estate, has not only added much to our knowledge of that subject but it has stimulated the average appraiser to a study of this work.

It has added to the appraiser's own confidence; and, undoubtedly, it has brought prestige to those whose work has shown the result of their study.

The great majority of our appraisers a few years ago were groping about looking for light. They were developing their own technique and presenting their views and methods with more or less diffidence and hesitation.

The encouragement to study, the ambition to do better work, the desire to produce appraisals that were really more than mere opinions, all these during the past few years have been fostered and directed by that group of experts connected with our National Association of Real Estate Boards who gave unselfishly of their time, their energy, and advice to those others who lacked some of their knowledge and experience. Now the average appraiser is emerging from the A B C. Class. He has reached a point where he feels he can absorb something in a more advanced study.

Here is a book that is an orderly comprehensive, readable treatise on the science of appraising real estate.

Great space is given by the author to the analysis of the things an appraiser should know, the background of knowledge he should have before he can competently exercise that judgment demanded in a valuation.

It is easy to agree with him that, "There is a proper method by which a given set of facts will be converted into a correct statement of value, while the use of improper methods with the same facts leads to material and serious error." Not all writers on the subject agree as to these methods. None of them go so far as to assert that on the basis of our present knowledge and experience appraising is an exact science.

The useful helpful thing that can be done by the writer on this subject is to point out what those things are that have developed from experience, from education, from study, and from economic history, that will point a way to the appraiser who is willing to learn. It is to this task that Mr. Kniskern applies himself and the result is a book that will be valuable to every appraiser and that will add his name to the list of those men who have made definite contributions to this science. Not all appraisers can claim to be professional. Not even a large minority of men who do appraising could be put in that high class. The average appraiser in the average city is a real estate broker whose appraisal business is his minor activity.

Kniskern has not written for that type of appraiser alone but he includes much practical instruction in his book that will be very helpful to him. In chapter after chapter he develops an exposition of pertinent subjects all of which will add to the appraiser's skill, his knowledge, and his ability to appraise.

Starting with "Value" as a subject, following with "Capital," "Money," "Investments," and "Market Price," he developes his treatise on the premise that "Income being the ultimate purpose of any investment" it follows that as a basic and fundamental principle that income should be accepted as the true criterion of value. Income, however, the author points out, may be present or future, in the form of money, use, or appreciation.

Especially interesting at this time is the author's chapter on "Going Value." This has been a troublesome feature of valuation to many appraisers and the author's clear, precise treatment will be helpful to a great many, especially to those whose work embraces industrial properties. Going value, particularly in industrial and in all special purpose buildings may be, the author demonstrates, quite different from market value.

An appraiser's finding as to value in these cases, Mr. Kniskern maintains, should be stated as the "going value to the present owner, or by some other equally clear statement of limitation." He devotes several chapters to "Mortgages and Financing."

"Appraising" and "Determination of Value" follow as the main part of the book with many excellent chapters on methods, details, and analysis.

The chapter on "The Appraiser" and the following one on "Titles, Estates, Liens" contain much that is fundamentally instructive both in ethics and legal information.

When Mr. Kniskern states, Chapter 13, page 235, that "The valuation of a property is the determination and proof of its value," he will find many who will disagree with him as to his use of the word "proof" and who will insist that that word if used must be construed in a very narrow sense. "Proof" usually means the assurance of certainty. Yet three intelligent, competent appraisers, using the same set of facts, will reach varying conclusions as to the valuation of the same property.

Into each appraisal has entered the factor of judgment. Where judgment and opinion combine with a mathematical process to reach a conclusion, the word "proof," many will hold, applies to one of the parties to an appraisal only, the valuator himself, and may not be accepted in its full sense by the employing party.

Real estate as an investment opportunity, its advantages, and disadvantages, are compared to other forms of investments, in one chapter, and by balancing the characteristics of one against the other, the author points the way to a determination of rate that is comparative and competitive.

His treatment brings additional light to this part of appraisal science. Examples of fee and leasehold appraisal problems involving typical conditions are presented with the author's solutions and the timely question today of the vacant and inadequately improved property is intelligently treated.

The writer's full skill and knowledge as well as his experience are displayed in that part of his book that treats of "Capitalization of Income" and the methods to be used to determine the proper rate. This question is highly controversial and is puzzling to most appraisers, and there is a wide spread between opinions. The author's wide experience in the mortgage investment field has brought to him great practical knowledge; and, with this background, his views on the rate question will command respect.

Many readers will be grateful to him for the excellent Table of Contents and the trouble that has been taken to include subtitles. These number about 600.

The book is one more helpful encouragement to appraisers generally and can be recommended to all those students of appraisal science who are seeking the way accurately to determine justified market value.

Maurice F. Reidy, M. A. I.

Worcester, Mass., March 1, 1933.

Babcock, Frederick M. THE VALUATION OF REAL ESTATE. New York: McGraw-Hill Book Co. 1932. 593 p. $5.00.

EVER since it became known that Frederick M. Babcock was writing a new book on *The Valuation of Real Estate*, appraisers everywhere have been anxiously awaiting its appearance, knowing that, in view of the excellence of his first book on this subject, published in 1924, a new publication by him would contribute substantially towards advancing appraisal knowledge to the point where it might properly merit designation as a "science," and the work of the appraiser as a "professional" activity. There will be no disappointment to those holding these expectations, for this book of nearly 600 pages not only merits the descriptive adjective "scientific", but the author boldly steps out and leads into the realms of some undiscovered and unexplored concepts, informing the reader on the very first page of the "Preface" that "the correctness of the methods described depends entirely upon the arguments presented, not upon the sanction of authorities." Nevertheless, least some self-designated "practical" appraisers conclude that the book must therefore be what they like to call "theoretical" and, in consequence, of little practical value, let it be carefully noted, as Mr. Babcock states, that "most of the methods described have been used in connection with *Actual Valuations*"; and there are no less than 105 examples of valuation procedure set forth in detail. Besides, Mr. Babcock's practical experience in real estate appraisal work has been too broad to permit him to turn out a work which would be other than of outstanding practical worth.

The subject-matter is arranged in 7 "Parts" and an "Appendix." There are 34 chapters; "Present-Value" tables; and a comprehensive index. The broad scope of the publication is indicated by the titles of the 7 "Parts": I—The Economic Background; II—The Valuation Data; III—The Theory of Valuation; IV—The Methods of Valuation; V—The Forecasting of Returns; VI—The Valuation of Returns; VII—Details of Valuation Procedure (includes: Depreciation, Building Life, Interest Rates, Fractional Rates, Valuation by Comparison, Cost Estimation of Buildings, Valuation for Specific Purposes, etc.). The entire subject-matter has been developed and arranged with one purpose in mind, viz., to develop, step by step, logically and scientifically, *Methods* of real estate valuation, Mr. Babcock stating that "references to appraisal data and to the economic nature of real estate values are included only incidentally in order to make a discussion of *Valuation Method* possible."

If the reviewer were asked to pick out what seemed to him to be the most outstanding features of the book, he would name these:

1 — The logical development of a theoretically correct method of valuation which is then developed into seven modified practicable methods covering the entire field of requirements in real estate appraising.

2 — A clear delineation of the character of the "depreciation and obsolescence" problem as related to realty valuation, and the drawing of the inevitable conclusion, viz., that valuation of improved real estate must give effect to the phenomenon, readily observable and commonly experienced, of declining future net earnings.

3 — The application of the principles of valuation set forth by means of 105 examples.

4 — The discussion of "Risk and Interest Rates" (both "over-all" and "fractional" rates), and the presentation for the first time of a series of charts designed to aid in the choice of plausible "fractional" rates of capitalization applicable to earnings of (a) buildings, (b) land, (c) leased fees, (d) leasehold interests in land, and (e) mortgage debt-service requirements.

The "theoretical" method of valuation is derived after the text has brought out certain items of economic thought and economic facts which are commonly observed and accepted; and deduces the valuation procedure implied thereby and the conclusions which logically follow. These factors and conclusions are set forth as "Axioms of Valuation" in a concise and interesting columnar tabulation so that the relationships are readily apparent. The common-sense character of this tabulation will appeal to practical minds, and the manner in which the conclusions are drawn and the reader, almost unaware of what is taking place, smoothly carried to the "therefore" of the analysis (i. e., the determination of the "theoretical" method of all real property valuation), will excite the admiration of the logician.

The seven methods outlined for actual practice are developed to fit the varying necessities introduced by the varying characteristics of real estate properties themselves. Four are designated as "income" methods, these being applicable to properties which return "dollar" incomes in the nature of either commercial rents or business profits. Two methods called "Replacement Cost" methods, apply in cases where there are neither "dollar" incomes nor market value evidences with which to guide judgment. The seventh method applies where market sales data constitutes the principal evidences of value. The methods are then utilized by application in the appraisal of (1) a store property; (2) an auto-parking lot; (3) a hotel; (4) a theater; (5) a factory; (6) a two story house; (7) a library. The appraisals (which illustrate *method* only) are made under varying assumed conditions, such as: in fee simple; leased fee; leasehold estate; equities; land vacant; at time of building (a) completion, (b) normal occupancy, (c) mid-life, (d) late-life. In these examples there are at least two features which stand out to the present writer:

1 — The prediction and valuation treatment of DECLINING future net earnings;

2 — The making of "building" value residual in the "mid-life" cases.

If the reviewer were to state but one outstanding contribution this book makes to progress in valuation procedure, he would say that it consists of the focusing of thought upon the necessity of including in valuation methods (instead of ignoring it) consideration of the commonly experienced reality of declining future earnings in the cases of many types of properties, and in practically all cases insofar as building earnings are concerned. This idea was introduced by Henry A. Babcock in 1927 in a model appraisal report prepared for the Appraisal Division of the National Association. In an article which appeared in the July, 1931 issue of *California Real Estate Magazine*, the present writer stated: "The processes of determining the equivalent present-worth of *Declining* future earnings . . . will, doubtless, during the next few years be given the place of importance which I believe they merit in appraisal procedure." It is significant, too, that a work on "Economic Approach to Valuation Procedure" just published by the Appraisal Division of The California Real Estate Association and written by Loring O. McCormick and George L. Schmutz of Los Angeles, includes consideration and valuation of declining future earnings in cases of realty valuation. Mr. Babcock publishes "Present-Worth" Tables for incomes which decline in accord with three stated premises with discount rates of from 7% to 15% and for 1 to 100 years. It is interesting to note that the Babcock premises assume declines to zero by equal yearly differences (straight line), or in the same manner as the value of a level annuity declines to zero with a 3½% or 10% rate, while the Schmutz-McCormick tables assume declines per annum at rates of 1%, 2%, or 3% of the initial year's earnings (the "Reducing-Balance" formula). These differences emphasize Mr. Babcock's statement: "No . . . study (of experience of building incomes) . . . has been made in which a sufficient number of instances were included to draw a general conclusion with respect to the exact shape to give such income curves. Hence the

curves presented . . . are selected empirically." Notwithstanding this condition, an important contribution towards *greater accuracy* (a much-desired goal) in value estimation is made by the treatment of this phase of the problem of valuation.

The chapters dealing with determination and choice of capitalization rates constitute a decidedly valuable addition to knowledge relating to such matters. Thirty-four factors which influence choice of capitalization rates are set forth in tabular form; and the five charts presented isolate, and provide for the assigning of individual weights to, as many as twenty-four of these factors in the selection of plausible rates applicable in the capitalization of earnings imputable to building, land, leased fee, leasehold, or mortgage debt-service. To illustrate: In the "Building Rate Chart" there is provision for: 17 kinds (business, apartments, etc.) or grades (best, average, etc.) of buildings; 5 ratings for physical condition; 6 for beauty, permanence, etc., of architectural style; 6 for quality of materials, etc.; 6 for various types of construction; 6 for efficiency of functional design; 10 for varying "expense-ratios"; 6 for anticipated fluctuation of revenues; and 6 for varying quality and reliability of the appraisal data. The individual consideration of so many (and other factors entering into the construction of these charts will minimize the possibilities of error and considerably enhance the accuracy of valuations. Mr. Babcock is careful to point out that the charts do not, and can not *determine* or *create* capitalization rates, any more than depth tables determine or create values, but expresses his belief that they may be found valuable aids in guiding judgment when used *with* judgment.

Doubtless some of the ideas presented in this book will provoke discussion and debate, arguments *pro* and arguments *con*, for all valuators are not agreed in all particulars by any means. For instance, there will be argument as to the appropriateness for realty valuation work of using the "Babcock" premise in valuing annuities instead of the "Hoskold" formula; there will be discussion as to whether "over-all" capitalization rates should be determined first or "fractional" rates first; there will be debate as to what premises should be preferred with reference to declining future earnings; and so on. Indeed such discussions constitute, in part, a *raison d'etre* for Mr. Babcock's book, and incidentally, he will be found to have good reasons for his views. What is most important is that progress will certainly be made as a result of the stimulus to thoughtful consideration of appraisal procedure which his courageous explorations of and ventures into new fields are bound to create. No appraiser, or any other individual interested in valuation work, who takes such activities seriously and desires to keep abreast of the rapidly advancing "appraisal" thought of the times, will want to be without this book; it again justifies inclusion of Frederick M. Babcock, its author, amongst the leaders in the ranks of the progressive appraisal fraternity, and constitutes an outstanding contribution to appraisal literature and to the advance of real estate valuation to a scientific status.

Ayers J. du Bois, M. A. I.

Los Angeles, Calif., Feb. 3, 1933.

LOS ANGELES BLUE BOOK OF LAND VALUES. Los Angeles: Land Value Book Publishing Co., 1932. 300 p. $12.50.

THIS volume is the first attempt to publish an unbiased analysis of property values in Los Angeles. Realtor Leonard F. Hammel, a member of the Los Angeles Realty Board, working in collaboration with S. Charles Lee, prominent Los Angeles architect compiled the information. The city was divided into 150 districts; front foot values were set on every piece of property; the figures were then checked against county tax appraisals; then another appraiser checked both figures and the differences were ironed out by arbitration. The compilers have attempted to set a fair market value, and not a forced sale value, a depression value, or a boom value.

Each page contains a map of a definite portion of the city showing streets and blocks. Bordering districts are indicated by the explanatory note "Adjoining map on page ." County assessor's figures are given in addition to the figures of the Blue Book assessors. Supplementary information of interest to appraisers is also included, as Los Angeles traffic count, corner lot tables, depth tables, thirty year graph of land values, and building construction costs. The volume is well indexed. An added feature of the book is the blank page facing each map for memoranda in keeping the figures up to date.

In using the *Blue Book of Land Values* it must be understood that the figures are not official but are merely an expression of opinion of the comparative value of that property to other properties within the area surveyed. As an indication of front foot values, it should be useful to appraisers interested in Los Angeles property.

C. M. Jones.

Chicago, March 1, 1933.

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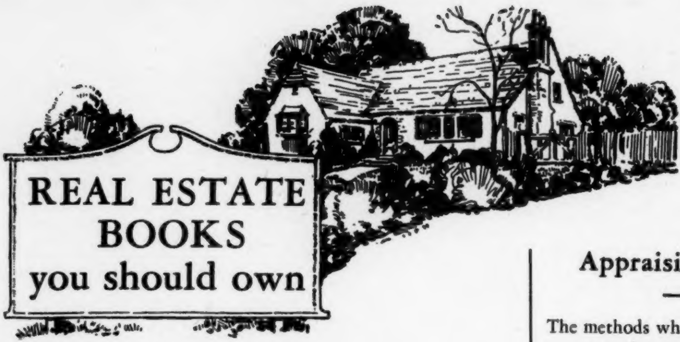

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Capitalization and interest rates.
Use of interest tables.
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Appraising by the unit foot method.
Adaptation of depth tables.
Appraising business corners.
Triangular lots.
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Building appraisals.
Plottage.
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Appraising homes.
Values due to shiftings of business.
Appraising property in "Twilight" zones.
Rental percentages based on gross sales.
Factors to observe in appraisals.
Testifying in court.
Physical equipment of the appraiser.

46 Diagrams and Tables

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